1996

Comment Letters to proposed statement of position: Accounting by insurance and other enterprises for guaranty-fund and certain other insurance-related assessments;

American Institute of Certified Public Accountants. Accounting Standards Executive Committee

AICPA

INTERNAL MEMORANDUM

Date: April 21, 1997

To: Karen Neloms

From: Elaine Lehnert

Subject: Comment Letters

Attached, please find copies of the comment letters received on the AICPA exposure draft of the proposed statement of position, *Accounting by Insurance and Other Enterprises for Guaranty-Fund and Certain Other Insurance-Related Assessments.* Please include these comment letters as part of the public record of the AICPA and make them available for public inspection at the AICPA library for one year or until April 5, 1998.

I am also enclosing a copy of the exposure draft.

Enclosures

List of Respondents to the Proposed SOP on Accounting by Insurance and Other Enterprises for Guaranty-Fund and Certain Other Insurance-Related Assessments

Letter Number	Commentator	Affiliation/Grouping
1	Harry D. Harkey, CPA	Sole Practitioner
2	The National Council of Self-Insurers (Douglas F. Stevenson)	Professional Organization
3	The National Council of Self-Insurers (2nd response) (Douglas F. Stevenson)	Professional Organization
4	CUNA Mutual Life Insurance Company	Industry
5	National Association of Insurance Commissioners	Professional Organization
6	State of California: Dept of Industrial Relations Self-Insurance Plans	State Insurance Dept.
7	Kramer Consulting Services, Inc.	Other
8	National Organization of Life and Health Insurance Guaranty Associations	Professional Organization
9	Travelers Insurance	Industry
10	Allstate Insurance Company	Industry
11	Life USA Holding, Inc.	Industry
12	New York State Society of CPA's	State Society
13	State of New York Insurance Dept.	State Insurance Dept.
14	Arthur Andersen LLP	Big 6
15	John Allen Life Insurance Company	Industry
16	Life/Health & Property/Casualty Interested Parties	Industry
17	American Insurance Association	Professional Organization
18	Ernst & Young LLP	Big 6
19	Coopers & Lybrand LLP	Big 6
20	American Council of Life Insurance	Professional Organization
21	Illinois CPA Society & Foundation	State Society
22	Institute of Management Accountants	Professional Organization
23	Society of Louisiana CPA's/ Accounting and Auditing Standards Committee	State Society
24	Lincoln Life Insurance Co.	Industry

AICPA

December 5, 1996

FROM HARRY D. HARKEY, CPA
V.P.
BOOKE SEMINARS
WINSTON-SALEM, NC

①
12/96

Accompanying this letter is an exposure draft of a proposed Statement of Position (SOP), *Accounting by Insurance and Other Enterprises for Guaranty-Fund and Certain Other Insurance-Related Assessments.* A summary of the significant provisions of the proposed SOP is included in the forepart of that document.

The purpose of the exposure draft is to solicit comments from preparers, auditors, and users of financial statements and other interested parties. AcSEC invites comments on all matters in the proposed SOP and particularly on the following specific issues. Respondents need not comment on all of the issues and are encouraged to comment on additional issues. Respondents should refer to specific paragraph numbers and include reasons for any suggestions or comments.

Scope

Issue 1: The proposed SOP would apply to all insurance enterprises (stock and mutual), including life and health insurance enterprises, property and casualty insurance enterprises, assessment enterprises, fraternal benefit societies, reciprocal or interinsurance exchanges, insurance pools (other than public-entity risk pools), syndicates, captive insurance companies, and other enterprises subject to guaranty-fund and certain other insurance-related assessments. In addition, entities that are not insurance enterprises but that self insure against loss or liability and are subject to guaranty-fund and certain other insurance-related assessments are included in the scope of this proposed SOP. Is there any reason to exclude enterprises other than insurance companies from the scope? Will non-insurance enterprises have or be able to obtain sufficient information or data to enable them to apply the provisions of this proposed SOP? Why or why not? don't know. No. their real liabil

Refer to paragraph 8.

Issue 2: This proposed SOP would apply to state- and regulatory-imposed assessments related directly or indirectly to underwriting activities and also to insurance-related assessments imposed by other authorities. Are there transactions that are captured by this scope that should be excluded? Alternatively, are there other assessments or transactions not captured by the scope that should be included? don't know.

Refer to paragraph 9.

Prospective-Premium-Based Assessments

Issue 3: Paragraph 19b of the proposed SOP specifies that for prospective-premium-based assessments the event that obligates the member insurer is the writing or renewal of the premiums on which the assessments are expected to be based. Alternatively, the insolvency could be considered the underlying cause of an insurance enterprise's obligation to pay future assessments. Is the writing of the premium the appropriate event to trigger the liability for prospective-based premium-based assessments, or would the insolvency be more appropriate? Why or why not? No liability if you don't write.

Refer to paragraphs 30-37 for the basis for AcSEC's conclusions.

Present Value

Issue 4: The proposed SOP allows a liability for assessments to be recorded at its present value by discounting the estimated future cash flows at an appropriate interest rate when the amount and timing of the cash payments are fixed or readily determinable. Should discounting be permitted? yes Should it be required? yes Why or why not? Economic reality, Disclose assumptions.

Refer to paragraph 40 for the basis for AcSEC's conclusions.

Transition

Issue 5: This proposed SOP would require adoption at the beginning of an entity's fiscal year (that is, if the SOP is adopted prior to the effective date and during an interim period other than the first interim period, all prior interim periods should be restated). Would another method of transition be more appropriate? yes, let it all hit Qtr adopted like FAS 109 change in tax law.

Refer to paragraph 23.

Effective Date

Issue 6: This proposed SOP would be effective for financial statements for fiscal years beginning after December 15, 1997, with earlier adoption permitted. Is the effective date appropriate? No. s/b effective 1997. the sooner the better.

Refer to paragraph 23.

1/6/97

Responses should be addressed to Elaine Lehnert, Technical Manager, Accounting Standards, File 3162.AS, American Institute of Certified Public Accountants, 1211 Avenue of the Americas, New York, NY 10036-8775, in time to be received by March 5, 1997. Responses also may be sent by electronic mail over the Internet to ELEHNERT@AICPA.ORG.

Written comments on this exposure draft will become part of the public record of the AICPA and will be available for public inspection at the AICPA library for one year after March 5, 1997.

Sincerely,

G. Michael Crooch, CPA
Chair
Accounting Standards
Executive Committee

Robert W. Granow, CPA
Chair
Assessments Task Force

Jane B. Adams, CPA
Director
Accounting Standards

The National Council of Self-Insurers
10 South Riverside Plaza, Suite 1530
Chicago, Illinois 60606
(312) 454-5110 FAX (312) 454-6166

December 13, 1996

Elaine M. Lehnert, Technical Manager
Accounting Standards, File 3162.AS
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Re: Proposed Statement of Accounting for Guaranty Funds, Second Injury Funds, and Other Related Assessments in Workers' Compensation

Dear Ms. Lehnert:

I just received your draft of this proposed rule. On behalf of the National Council of Self-Insurers, a trade association of employees who self-insure their workers' compensation liabilities, I need to pose some questions, before we take a position on the proposal.

Perhaps, we are naive, even ignorant, for lack of prior participation in your discussions. But, I have examined carefully your release of December 6, 1996. Before I can take the proposal to my directors, I need more understanding.

I can relate to your desire for full disclosure in financial statements. But, it seems to me you are requiring disclosure of facts and figures which are unavailable to a reporting entity, actually of facts and figures which are unknowable to anyone.

Your proposal requires the determination of two figures by each reporting entity:

1. What is the amount of future liability of guaranty funds, second injury funds, and administrative funds, and

2. What is the proportionate share of such liability of each insurance and self-insured company.

I don't see how you determine either figure. Let me discuss the problem of these determinations in reverse order.

A. The "proportionate share" determination.

Your proposal assumes there is some global data from which the "proportionate share" of each insurance company and self-insured company can be determined. ***No such data exists.***

No one can tell you how much of the workers' compensation market is under insurance companies, and how much is under self-insured companies, much less how much may be under hybrid arrangements. No one can tell you globally, nor can any state authority tell you locally. The data just doesn't exist.

Nor can you "construct" any model to acquire such information. The National Council on Compensation Insurance may have gross premiums information for the 36 states it serves. But, that won't tell you the amount of self-insurance in those states. Self-insurers don't generate "premium" figures; individual self-insurers may know their "cost" for workers' compensation, but no one collects aggregate cost data for self-insurers.

Even if self-insurance data were collected, it would not be comparable to insurance "premiums." Such "premiums" include agents' commissions, for example, an expense self-insurers avoid. Further, your proposal gives no clue concerning how to handle the distortion of the somewhat new "high deductible" policies, where the premium charged by the insurance company does not reflect the workers' compensation liability involved. Nor does your proposal reflect how to handle the premium and liabilities of group-self-insurers, a growing segment of the market.

I suggest therefore, that your proposal cannot be implemented in the market place. One of its essential elements, "proportionate share", simply cannot be determined. Without this determination, your proposal fails.

B. Determining the amount of "future liability"

I suggest that determining the amount of "future liability" is just as futile as determining "proportionate share." I respectfully suggest that some of the concepts stated in the proposal are wrong.

1. Are these assessments a "future liability"?

Let's take Second Injury Funds as an example. These are created and managed by state law to cover pre-existing and non-work-related disabilities, which should not be charged against the employer (insured or self-insured) in the particular workers' compensation claim. The money to pay these extraneous disabilities is derived from assessing all members of the workers' compensation community, insured and self-insured.

By definition, these second injury fund liabilities do not arise out of the accident covered by the insurance policy, and thus are not a liability against the policy "premium." Your proposal "force-feeds" these second injury liabilities into liabilities of a particular insurance company, as a liability to be charged against the premium for that year's policy. Your proposal does not reflect the actual *legal* responsibilities involved; it assumes a direct legal liability where none exists.

The responsibility of an insurance company or self-insured employer in a Second Injury Fund state is merely to pay the annual assessment levied by the state. In all the states I am familiar with, that is a "pay as you go" assessment for the annual cash outlay anticipated by the fund.

One can expect a similar assessment every year. But, if an insurance company ceases business in the state, assessments stop, thus demonstrating that this is no longer a liability, much less a "future liability" of the individual company.

I suggest that guaranty fund assessments in the insurance industry are similar to my description of Second Injury Fund operations. I know that the self-insurance guaranty funds operate this way; members are assessed only for the anticipated annual cash outlay. If a company ceases to be self-insured, it is not liable for future assessments. In short, these are not "actuarial" assessments requiring a current reserve for all the future assessments which may be anticipated.

Even more so, assessments for the administrative costs of a state's workers' compensation agency are ***annual assessments***, based on the annual budget adopted by the agency. It seems inappropriate to force a reporting entity to anticipate what the state agency will budget over the next 20 years, and report a current liability for it.

I suggest that these assessments are no different than annual real estate taxes, and should be treated as such. Of course, one can anticipate an annual tax bill as long as one owns the real estate. But, I know of no accounting principle, or logic, which would require one to show currently a liability for the next 20 years of real estate taxes.

2. Can a reporting entity determine the amount of "future liability"?

An individual company has no access to the data necessary to determine the amount of "future liability." Again, using Second Injury Funds as an example, all the files are in the hands of the state agency. No individual company has the files to make a determination of the total future liability of the Second Injury Fund.

I am aware of only three states which have attempted to arrive at the total liabilities of their second injury funds, and there is considerable disagreement about the figure. Connecticut says its fund has 2 to 6 billion dollars of future liabilities. That is not a very definitive figure for use in financial statements.

Still, what will your proposal use in the other 47 states? They have no gross figure, and no one can compel the state even to make a study about it. Obviously, no individual company, nor your CPA society can compel such a study.

So, your proposal has empty blanks and no way to fill in these blanks. I don't see how it can be implemented.

Conclusion

At some time, I am likely to be asked by my members for the figures required by your proposal. I am currently at a loss how to respond.

It is in that spirit that I pose the questions in this letter.

Very truly yours,

Douglas F. Stevenson

Douglas F. Stevenson
Executive Director

DFS:rmh

The National Council of Self-Insurers

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Chicago, Illinois 60606
(312) 454-5110 FAX (312) 454-6166

January 10, 1997

Elaine M. Lehnert, Technical Manager
Accounting Standards, File 3162.AS
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Ms. Lehnert:

I enclose an article on this proposal. I suggest that when you require an entity to report a number, you must tell him how he can find that number. It simply is not knowable.

Second Injury Funds, for example, are liabilities of state governments, not of insurance companies or self-insured employers. State government gets the money to pay its liabilities by assessing employers and insurance companies for its annual needs - just as a state assesses other taxes for its annual needs.

In short, these annual assessments are indistinguishable from annual taxes imposed by the state. Yet, no CPA would suggest that any company accrue 20 years of anticipated state taxes and report that figure in its current financial statements.

It is true that there are liabilities out there somewhere, just like our national debt is out there. But, is the national debt an individual liability? Under the concepts of your proposed rule, each of us should include a *pro rata* share of the national debt in current financial statements. Will that be the next proposed rule?

I understand the Institute is working with the National Association of Insurance Commissioners on this proposal. May I ask you to send a copy of this article and this letter to the NAIC? I do not have the address.

You should be aware that the NAIC has jurisdiction only over insurance companies, and has no authority over self-insurers. Self-insurers do not gather collective data, and cannot be compelled to do so. Thus, there is no data or mechanism which can "rationally predict" one's *pro rata* share of second injury fund liabilities, even if the total liability could be ascertained.

Very truly yours,

Douglas F. Stevenson
Executive Director

DFS:rmh
Enclosure

CPA Institute Requires Showing More Liabilities

By

Douglas F. Stevenson

The American Institute of Certified Public Accountants is considering a proposed rule affecting all insurance companies and self-insured employers engaged in workers compensation. Its proposal was published on December 5, 1996. There is an open period for comment until March 5, 1997.

The proposal, if adopted, will require every insurance company and self-insured employer to include in its current financial statements its pro-rata share of all the liabilities of second injury funds, guaranty funds for insolvent insurers and self-insurers, and other assessments for state administration costs.

The proposed rule seems to be prompted by recent actuarial studies of some second injury funds. Connecticut, for example, may have $6 billion of liability; that of Kentucky and Florida may exceed $2 billion. While no one knows the liabilities of the insolvency guaranty funds of insurers and self-insurers, or the anticipated budgets of state administrators for annual operating expenses, the proposal embraces these potential liabilities, too.

The effect of this proposal, if adopted, would be a charge against equity, against the capital and surplus of every company. For insurance companies in particular, the effect could be painful. Under traditional standards of prudent management, an insurance company does not issue policies beyond a three-to-one ratio of risks assumed against capital and surplus. By requiring an insurance company to show these additional liabilities, the reduction in capital and surplus forces a reduced capacity to write insurance. (In a few instances, this could result in insolvency).

Self-insured companies would also incur this charge against equity, but without the severe consequences of such charges to insurance companies.

This author has sent a comment to the accounting institute questioning:

A. Is the amount of liability knowable?

B. How can a reporting entity determine its pro-rata share, even if the total liability is known?

C. Are these assessments really liabilities, or just an annual expense of doing business similar to annual taxes under traditonal accounting principles?

A. Is the amount of liability knowable?

Examine second injury funds as an example. These are state operated mechanisms designed to encourage the employment of persons with pre-existing disabilities, by limiting the immediate employer's liability to that caused by his accident; any added liability from pre-existing conditions is paid by the state's second injury fund. The state acquires the money for paying these pre-existing disabilities by assessing all employers, insured and self-insured, on the basis of premiums or the compensation paid in the previous year.

The state assessment is not actuarial over the life of a claim, but is only for the annual outlay required. The claim files are in the hands of the state agency, and no individual insurance company or self-insurer has access to them. None has the ability to determine the future liabilities of the second injury fund, much less its *pro rata* share of such liabilities.

While three states, Connecticut, Kentucky and Florida, have had actuarial studies of the files in their possession, (and there is considerable disagreement about the accuracy of these studies), none of the other 47 states has done so. Neither the Accounting Institute nor the National Association of Insurance Commissioners can compel a state to make such a study. Thus, the total liability of all second injury funds is unknowable to any reporting entity.

The liabilities of insolvency guaranty funds of insurance companies and self-insurers are also unknowable to a reporting entity. These are managed by separate entities, and their assessments are only for the required annual outlay, not on an actuarial basis. The ultimate liability here is unknown and unknowable to a reporting entity.

Assessments for the cost of administering the state agency depend upon the annual budget adopted by the state agency. No reporting entity can know or even predict future government budgets. To require an entity to report a current liability for future governmental budgets requires it to report the unknowable and the unpredictable.

In summary, the amount of liability which each reporting entity must share is unknown and unknowable to the reporting entity. Nor can it be "reasonably estimated" based on any facts or data known to the reporting entity.

B. How can a reporting entity determine its *pro rata* share?

Assuming the total liability is "knowable", there is no basis for determining the pro-rata share of any insurance company or self-insured employer for the liability.

The proposal assumes there is some global data base and each reporting entity is part of that data base. Such a data base does not exist.

There are opinions concerning market shares in workers compensation, but only opinions unsupported by data. The data for many insurance companies are compiled by the National Council on Compensation Insurance, but participation in that collection is voluntary, and is limited to 36 states. The other 14 states may or may not have a similar agent. Ohio, Washington, and West Virginia are state-fund states where private insurance for workers compensation is forbidden. There is self-insurance in these three states, but in North Dakota and Wyoming, there are neither private insurance companies or self-insurance.

From this "hodge-podge" of states, "market share" of the insurance companies is again unknowable. No reporting insurance company can know or guess its pro-rata share of liabilities among fellow insurance companies.

Further, self-insurers have a substantial portion of the workers compensation market. Opinions range from 20 to 35 per cent, but no data support any figure.

Even more unknowable is the pro-rata share of self-insurers among themselves. Self-insurers keep their cost information to themselves, and no one even purports to collect data about self-insurer costs or liabilities. Some states artificially assign a "premium" figure to a self-insurer, for comparison, but this produces an inaccurate "apples and oranges" comparison. For example, self-insurer costs do not include agent commissions or profits; insurance premiums do.

Consequently, it is impossible for any insurance company or self-insurer to know its pro-rata share of all liabilities, and, it is impossible to construct any "model" from which "rational estimates" can be drawn.

In summary no reporting entity can determine its pro-rata share of total liabilities in any rational manner, even if the figure for "total liabilities" is knowable.

C. Are these assessments liabilities or just an annual expense of doing business similar to annual taxes under accounting principles?

This articles does not question the importance of financial statements reflecting all long term liabilities of a reporting entity. Insurance companies and self-insurers do establish reserves for long term liabilities.

It does question the basic concept of the proposed accounting rule, that the potential obligations of guaranty funds, second injury funds and administrative assessments are such "long term liabilities." An insurance company or self-insurer establishes a "reserve" for the anticipated cost of any claim it is legally obligated to pay in the year of the occurrence and future years as well. Each has (or ought to have) all the facts, and the responsibility for handling or defending the claim, and a reserve is often adjusted as facts develop.

The proposed rule applies this concept to areas where it has no application. For example, second injury fund liabilities are not the liability of any reporting entity. It has no file, no management function in claims handling, and no knowledge about the file. The file and the liability is in the hands of the state agency. Actually and conceptually, individual insurance companies and self-insurers are removed from liability.

They may be required to pay an assessment for the annual expenditures of the second injury fund, just as they pay taxes for other operations of state government, in the form of income taxes, franchise taxes and real estate taxes. These "assessments" are conceptually like taxes.

That these are "taxes", not "liabilities," is demonstrated by the fact that if an insurance company stops writing premiums, or an employer abandons self-insurance, the assessment process stops; that is not true of genuine "liabilities."

Obviously, these "assessments" are not direct liabilities of the reporting entity. They are annual expenditures to be anticipated just like real estate and income taxes.

But, despite such anticipation, one would not consider capitalizing future real estate or income taxes for the next 20 years, and showing this figure as a current liability. That would distort other accounting principles. Yet, this is what the proposal requires.

In summary, the concept of the proposed rule, that the liabilities to guaranty funds, second injury funds, and administrative funds, are just like the reserves set for accidents occurring in policy year, is wrong.

These may be called "assessments", but in fact are just taxes levied by government on an annual basis.

Conclusion

For these reasons, we urge reconsideration of this proposal, of its basic concepts as well as just how a reporting entity can determine what to report, if the proposal is adopted.

If anyone wishes to send comments during the "comment period," such comments such be sent to:

Elaine M. Lehnert, Technical Manager
Accounting Standards, File 3162-AS
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

January 17, 1997

CUNA MUTUAL LIFE
INSURANCE COMPANY

Ms. Elaine M. Lehnert
Technical Manager
Accounting Standards, File 3162.AS
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Ms. Lehnert:

This letter is in reference to the Exposure Draft of the AICPA Proposed Statement of Position, entitled "Accounting by Insurance and Other Enterprises for Guaranty-Fund and Certain Other Insurance-Related Assessments."

With regard to the Statement of Position, Background Information, Guaranty-Fund Assessments, Item 3 (page 13 of the bulletin I reviewed), one thing is not clear to me. Specifically, does the "insolvent insurance enterprise," for which "insurance enterprises licensed to sell insurance" are being assessed, have to also be a licensed insurer in the state making or proposing the actual assessment in order for the assessment to be a legitimate liability? This may be more of an insurance regulatory question, but I do think it needs to be clarified. As an insurer licensed in a particular state, I would not want to pay an assessment for the debt of another insurer NOT licensed in that same state.

I have enclosed a copy of the page in question and am raising the issue for your consideration in clarifying the AICPA Statement of Position.

Sincerely,

James A. Beam

James A. Beam, FLMI
Operational Accounting and Control Leader
CUNA Mutual Life Insurance Company

me0117_1
Enclosure

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STATEMENT OF POSITION

ACCOUNTING BY INSURANCE AND OTHER ENTERPRISES FOR GUARANTY-FUND AND CERTAIN OTHER INSURANCE-RELATED ASSESSMENTS

INTRODUCTION

1. Insurance enterprises are subject to a variety of assessments, including those by state guaranty funds and workers' compensation second-injury funds. Some entities other than insurance enterprises may be subject to insurance-related assessments because they self insure against loss or liability. This SOP refers to all entities that are subject to guaranty-fund and other insurance-related assessments as insurance enterprises or member insurers. Current accounting practice by insurance enterprises for assessments and related recoveries is diverse. Some of the diversity is a result of fundamental differences in the methods for assessing insurers. However, similar assessments are not being accounted for comparably among insurance enterprises. Some insurance enterprises account for assessments on a pay-as-you-go (cash) basis, whereas others account for assessments on an accrual basis. Furthermore, the methods for accrual are varied. Some insurance enterprises recognize a liability for the entire portion of the estimated cost of an insolvency at the time of the insolvency. Yet others recognize a liability related to assessments that are dependent on the writing of future premiums as those premiums are written. This Statement of Position (SOP) provides guidance on accounting by insurance enterprises for guaranty-fund and certain other insurance-related assessments.

2. As the prevalence and magnitude of guaranty-fund and other assessments have increased, concern about the diversity in practice also has increased. This SOP was undertaken to reduce diversity in practice, improve comparability of amounts reported, and improve disclosures made by insurance enterprises with respect to guaranty-fund and other assessments.

BACKGROUND INFORMATION

Guaranty-Fund Assessments

3. Most states have enacted legislation establishing guaranty funds. The state guaranty funds assess insurance enterprises licensed to sell insurance in the state (member insurers) to provide for payment of covered claims or to meet other insurance obligations, subject to prescribed limits, of insolvent insurance enterprises. Most state guaranty funds assess member insurers for costs related to a particular insolvency after the insolvency occurs. At least one state, however, assesses member insurers prior to insolvencies.

does the insolvent company need to be licensed in the state making the assessment?

4. State guaranty funds use a variety of methods for assessing member insurers. This SOP identifies three primary types of guaranty-fund assessments.

a. *Retrospective-premium-based assessments*. Most state guaranty funds covering benefit payments of insolvent life and health insurance enterprises assess member insurers based on premiums written *prior* to the insolvency. Assessments for a given insolvency are based on an allocation derived from pre-insolvency premiums and usually are made over several years after the insolvency occurs. Annual assessments generally are limited to an established percentage of a member insurer's average premiums for the three years preceding the insolvency.

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National
Association
of Insurance
Commissioners

March 3, 1997

Ms. Elaine M. Lehnert
Technical Manager, Accounting Standards
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Re: Proposed Statement of Position Accounting by Insurance and Other Enterprises for Guaranty-Fund and Certain Other Insurance-Related Assessments; File 3162. AS

Dear Ms. Lehnert:

Pursuant to AICPA's December 5, 1996, letter the regulatory members of the NAIC/AICPA Working Group offer the following comments on the above referenced exposure draft:

Paragraph 19(b). The conclusion, that for prospective-premium-based assessments the event that obligates the member insurer is the writing or renewal of the premium on which the assessments are expected to be based, appears to be an inappropriate application of FASB Statement No. 5. It is our opinion, that the probability criterion of Statement No. 5 is met upon the determination of an insolvency which will result in guaranty fund assessments. At the point in time when regulatory officials deem an insurance enterprise insolvent to a magnitude that will trigger guaranty fund assessments, a liability exists which will be borne by all insurers writing similar business in the state. The event creating the obligation has occurred.

The writing of premiums, either retrospective or prospective, is a method to allocate an existing and certain obligation. An enterprise's ability **and intent** to reduce premium writings subject to known guaranty fund assessments are issues which should be considered under the estimation criterion of Statement No. 5. Therefore, the insolvency rather than the writing of premium would be the appropriate event to trigger the liability for guaranty fund assessments.

Paragraph 20. Discounting should not be permitted. Since FASB is still considering the role of present-value-based measurements in financial reporting, it would not be consistent or conservative to allow discounting absent appropriate guidance on present-value methodologies and discount rates.

Please feel free to contact me if you have any questions.

Sincerely,

Douglas C. Stolte /pad

Douglas C. Stolte
Chair, NAIC/AICPA Working Group
(804) 371-9869

DCS:pad

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STATE OF CALIFORNIA Pete Wilson, *Governor*

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February 21, 1997

ELAINE M LEHNERT
TECHNICAL MANAGER
ACCOUNTING STANDARDS
AMERICAN INSTITUTE OF CPAS
1211 AVENUE OF THE AMERICAS
NEW YORK NY 10036-8775

Dear Ms. Lehnert:

RE: File 3162-AS

Your Institute has proposed revised accounting rules for insurance carriers and self insured employers published on December 5, 1996 concerning booking pro-rata shares of liabilities for various types of workers' compensation funds. These proposals would apply to workers' compensation insolvency guarantee funds, second injury funds, uninsured employer funds, and various State assessments to pay for State workers' compensation administration overhead expenses as well as the liability in these various funds.

Your proposal does not indicate that your Institute has a clear understanding of these funds and assessments. As a result, your proposals -- if finalized and implemented -- would cause many insurance carriers and large self insured employers to be unable to comply with the proposals. And even for those carriers or self insurers that might be able to comply, the resulting information would be confusing -- at best -- for anyone reading the financial reports of the carrier or self insurer.

<u>WHO IS THE PARTY THAT IS LIABLE FOR THE WORKERS' COMPENSATION FUND LIABILITIES AND VARIOUS ASSESSMENTS</u>?

The first thing that comes to my mind after reading your accounting proposals is that the carrier or self insurer is <u>not</u> always the party legally responsible for the liability in question. Often the Fund itself is the party that is legally responsible for the liability. In other cases, it is a State agency that is legally responsible. The carriers and self insurers are often "stockholders" or merely parties that are taxed or assessed to pay an annual fee to support the Fund, State agency operation or overhead expense. A couple of different examples here in California will illustrate this point:

1. Workers' compensation self insurers in California are by statute essentially stockholders in the Self Insurers' Security Fund, a private, non-profit mutual benefit corporation that guarantees payment of workers' compensation benefits of insolvent, bankrupt or defaulting self insured employers. (Labor Code Section 3740 et. seq.). In the event of an insolvency, default or bankruptcy, the Security Fund is the legally responsible party to pay all liabilities. It has the right to assess the self insurers to fund any shortfall in liabilities over and above the security deposit posted with the State. As a post-funded guarantee fund, the Security Fund collects funds to pay any shortfall in deposit by an annual assessment mechanism, even though there may be no actual assessment made in any given year or years. If an employer leaves self insurance, the liability of the Security Fund to assess this employer remains for only 3 years and terminates. At no time is the self insured employer liable for anything greater than the annual assessment from the Security Fund and even this terminates 3 years after leaving self insurance.

2. The Uninsured Employers Fund (UEF) in California is a State operated funding mechanism to pay workers' compensation benefits to injured workers where their employer failed to secure compensation obligations with a workers' compensation policy or through legal self insurance as required by statute. As part of State government, the entire UEF liability rests with the State Treasury, unless the State finds a carrier's policy or self insured employer or the actual employer who is, in fact, responsible for the claims(s) in question. (Labor Code Section 3716 et. seq.) The UEF is supported by payroll taxes, general funding and recoveries from other responsible parties. At no time are the carriers or self insurers financially responsible for UEF liabilities (unless the injured worker was covered under a policy or was their employee). However, both the carriers and self insurers are assessed payroll taxes -- along with all other employers -- to fund among other things, the Uninsured Employers Fund's workers' compensation liabilities. At no time is either a carrier or self insurer liable for anymore than their annual payroll tax.

3. Very similar to the Uninsured Employers Fund is another California workers' compensation funding arrangement for second injuries, called the Subsequent Injury Fund. This fund is liable for that portion of a workers' compensation claim due to a previous permanent disability, or physical impairment where the initial injury or impairment is, for example, pre-existing and non-industrial. The Subsequent Injury Fund is also State Treasury liability. It is offset by recoveries from other responsible carriers or self insurers and payment of non-dependent death claims to the State. (Labor Code Section 4750 et. seq.) Essentially about 2/3 of the liabilities come from the State General Fund and 1/3 from death without dependents benefits. Only the latter -- death without dependents are liabilities of a workers' compensation carrier or self insurer to pay over to the State. In our arrangement, the carrier or self insurer already carries the death without dependent liabilities on its books, but neither the carrier or self insurer is liable for the previous permanent disability or physical impairment.

Each State has differing arrangements for it various workers' compensation liabilities, funds, and assessments. Most of these funds do not estimate their total potential liability nor do they have a means to "prorate" shares to any given policy holder, carrier or self insurer. Your proposals do not appear to recognize who is liable for the workers' compensation liabilities of these funds.

<u>WHAT IS THE TOTAL LIABILITY</u>?

The next problem with your proposals is that you assume the liabilities of the workers' compensation funding mechanisms can be estimated in total, then prorated to each carrier or self insurer. This is not the case in my experience. Consider the insurance company guarantee fund or self insurance guarantee fund as an example.

For most workers' compensation insurance company guarantee funds and self insurance guarantee funds (both essentially the same idea), it is not possible to know the ultimate amount of liability of the guarantee fund. They essentially guarantee all liability of all carriers or all self insurers (to the extent specified in each State's statutes) over and above any security deposit posted by the carrier or self insurer with the particular State. The individual carrier's share of the ultimate liability is whatever occurs under its policies for all policy holders. The total liability belongs to the carrier alone. If the carrier becomes insolvent, the guarantee fund assumes the insolvent carrier's liability and may assess other carriers a surcharge on premium (in this State) to collect the shortfall over several years. At any point in time, it is difficult -- if not impossible -- to estimate what the insolvent's carrier liability will end up totaling.

Many diverse factors play a part in the liability determination -- Will another carrier step in and buy the liabilities at some point? What is the statute of limitations for filing workers' compensation claims in the State? Will the insolvency trustee do a good, great or poor job in settling claims? Was there excess insurance or reinsurance coverage? How far along is the insolvency -- 1 year, 5 years, etc. How many insolvency's are there in any year or in total over the years? In short, it is very difficult to know what the real liability is with any degree of certainty. Given this situation, to then ask the carriers or self insurers to book a pro-rata share of all insolvency's liabilities in just one State will be little better than guesswork. For a nationwide carrier or self insurer, the numbers to be booked will be staggeringly large, very soft in substance, and there is no way for a CPA to verify any number provided.

Your proposal also does not appear to take into account changes that would occur in the pro-rata figure to be booked if a self insurer left self insurance and returned to fully insured status, or vice versa. The prior pro-rata share would disappear either immediately or in a few years (1-5 years depending on the State) for any "self insurance" guarantee fund's liabilities. This could cause wide fluctuations in reported liabilities on the employer's financial report from one year to the next. This would suggest that the employer did not really owe the pro-rata share in the first place, so why book this liability?

RECOMMENDATIONS.

Many States require, by statute and or regulations, the workers' compensation carrier or self insurer to pay assessments for various funds and State operations as a condition of doing business in the State as a carrier or self insurer. Many of these funds and administrative charges are more truly an annual expense item for each carrier or self insurer or a "tax" (regardless of what it is called). It would seem more reasonable for the carrier or self insurer to book a figure representing what assessments or charges it paid in the current year in all States for all workers' compensation related funds and assessments. In this manner, such charges would be treated more like any other annual expense item or tax payment. This would seem to be a more logical method and has the advantage of being one that a CPA could verify the figure as being correct.

My recommendation would be to develop a new proposal (if one is truly needed at all) that would treat such workers' compensation and assessments as a annual expense item or an annual tax to be reported.

Sincerely,

MARK B. ASHCRAFT
Manager

MBA/mg

cc: Joe Markey, Secretary-Treasurer
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February 26, 1997

Ms. Elaine M. Lehnert, Technical Manager
Accounting Standards, File 3162.AS
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1211 Avenue of the Americas
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Dear Ms. Lehnert:

We are pleased to present this comment letter on the proposed Statement of Position on "Accounting by Insurance and Other Enterprises for Guaranty-Fund and Certain Other Insurance-Related Assessments."

Issue 1

We do not believe there is any valid reason to exclude enterprises other than insurance companies from the scope of the SOP. We believe that non insurance enterprises will be able to obtain sufficient information or data to enable them to apply the provisions of the proposed SOP as they would have access to the same information or data as is available to insurance companies.

Issue 2

We are not aware of any transactions that would be captured by the scope of the SOP that should be excluded. We are not aware of any assessments or transactions that do not appear to be captured by the scope of the proposed SOP that should be included. However, we believe paragraphs 1 and 6 should be expanded to identify the federal second-injury fund (administered by the Department of Labor) as well as state second-injury funds.

Issue 3

We believe that the basis for recognizing a liability related to prospective-premium-based assessments should be the insolvency of an insurance company for the reasons discussed in paragraph 32, and because once there is a formal determination of insolvency, the criteria established in paragraph 10 have been met.

We recognize, however, that this position would require insurance enterprises that enter a new state or increase market share in a state to accrue a liability for assessments related to an insolvency that occurred before they entered that state or increased their market share. We believe the assessment liability would be one of the non deferrable costs associated with entering into a new state or increasing market share.

Issue 4

We believe that an insurance enterprise should discount its liability for future assessments when the amount and timing of the cash payments are fixed or reasonably determinable if the insurance enterprise discounts its long-term policy liabilities. If the insurance enterprise does not discount its long-term policy liabilities, it should not discount its liability for future assessments. If discounting is permitted, the SOP should provide some guidance material, including an example of how the discounted liability should be determined. Also, the term "readily determinable" (as used in the description of Issue 4) and "reliably determinable" (as used in the "Summary") should be defined. It is believed that the better term would be "reasonably determinable."

Issue 5

We believe the proposed method of adoption is appropriate.

Issue 6

We believe the proposed effective date is appropriate.

Other comments

(1) In paragraph 10c, the word "loss" should be changed to "assessment," so the sentence reads "The amount of the assessment can be reasonably estimated."

(2) Paragraph 11 should be eliminated and "administrative-type assessments that are not loss based" should be included in paragraph 10. (At present, the only difference between paragraph 10 and paragraph 11 is that paragraph 10 includes the statement "The amount of loss [assessment] can be reasonably estimated," which should also apply to administrative-type assessments that are not loss based.)

(3) Footnote 4 at the bottom of page 15 should be clarified. It presently reads "A formal determination of insolvency occurs when a member insurer meets a state's statutory definition of an insolvent insurer." If an insurance enterprise

issues financial statements showing that its liabilities exceed its assets, it has met the statutory definition of an insolvent insurer. However, the presumption of the probability of an assessment should be based on a determination of the need for an assessment by the state insurance department or a court of competent jurisdiction as a result of an insolvency, not simply the issuance of financial statements showing an entity to be insolvent.

(4) Paragraph 17 should identify the type of information or data to be requested from the guaranty associations to provide the basis for a computation of the estimated liability. It would also be helpful if the SOP included a draft letter requesting such information or data from the guaranty associations and an illustration of how the estimated liability should be computed.

(5) Paragraph 21 should include an example of how to compute the portion of an assessment that is recoverable.

(6) Paragraph 38 should indicate that "incurred losses" include incurred but not reported losses.

Sincerely,

Loren Kramer

Loren B. Kramer

KCS

NOLHGA

National Organization of
Life and Health Insurance
Guaranty Associations

March 3, 1997

Ms. Elaine M. Lehnert
Technical Manager, Accounting Standards
American Institute of CPAs
1211 Avenue of the Americas
New York, NY 10036-8775

Dear Ms. Lehnert:

On behalf of the National Organization of Life and Health Insurance Guaranty Associations (NOLHGA) and the National Conference of Insurance Guaranty Associations (NCIGF), we are pleased to have this opportunity to comment on the exposure draft (ED) of the proposed Statement of Position (SOP), *Accounting by Insurance and Other Enterprises for Guaranty-Fund and Certain Other Insurance-Related Assessments* which was released by the Accounting Standards Executive Committee (AcSEC) of the AICPA for public comment. The body of this letter discusses what we believe are the more significant issues regarding the ED; these and other issues are discussed in more detail in the attachment to this letter. Please note the views expressed in this letter may not represent all of the NOLHGA and NCIGF membership (guaranty associations) since we have not had time solicit their comments on this response.

Estimation of a Liability

Although the occurrence of an insolvency certainly meets the probability standard of Statement of Financial Accounting Standards No. 5 (FAS 5), *Accounting for Contingencies*, we do not believe the liability can be reasonably estimated by insurance enterprises without considerable input from guaranty associations. Even with input from guaranty associations, the estimated cost figures may still be significantly flawed. Consistent with FAS 5, we believe that because the liability cannot be reasonably estimated, footnote disclosure is more appropriate.

In order to estimate the liability for guaranty association assessments, an insurance enterprise must estimate market share, the amount of the insolvency subject to guaranty association coverage, the amount of cash the guaranty association has available from other sources (e.g., inter-fund borrowing or the application of excess cash from other insolvencies) and the estimated timing of cash flows (to estimate the amount of investment earnings available to the guaranty association). Of these various assumptions, there is only one variable which the insurer can reasonably estimate: its market share.

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The most logical source for obtaining the necessary assumptions to estimate a guaranty association liability would be from organizations such as NOLHGA and NCIGF. Indeed, paragraph 17 of the ED states that insurance enterprises can obtain information to assist in estimating the total guaranty association cost or the following year's assessments (as appropriate) for an insolvency from organizations such as NOLHGA and NCIGF.

NOLHGA currently produces a report which includes estimates of the cost of life/health/annuity insolvencies in which they are involved (generally multi-state insolvencies). However, this report excludes many items which are unknown to NOLHGA such as single state insolvency costs, direct claims or expenses paid by individual guaranty associations, estimated asset recoveries from either estates or litigation against third parties, timing of assessments, guaranty association cash flows, etc.. NCIGF currently has no such process in place. This difference in approach is due primarily to the additional uncertainties inherent in the liquidation of an insolvent property/casualty insurer and is exacerbated by the difference in contractual obligations of life/health/annuity policyholders versus property/casualty policyholders. In the case of life/health/annuity policies, the contractual terms and obligations of the insolvent insurer are generally fixed. For property/casualty insurers, however, the obligation to policyholders is less certain, particularly where there are asbestos and environmental exposures.

Due to the uncertainties in estimating the liabilities of an insolvent estate, the guaranty association does not have an estimate of the net liability at the date of insolvency. In the case of a property/casualty insolvency, it takes a minimum of 6 to 9 months to get a reasonable estimate of case basis reserves and longer for incurred but not reported reserves. Once such estimates are obtained, it takes several more months to obtain an estimate of by-state liabilities so that each guaranty association can inform member insurers of a "gross liability." As a result of these difficulties, guaranty associations generally use a cash basis or modified cash basis of accounting for insolvent estates.

In the case of an insolvent property/casualty estate with asbestos and environmental exposure on the date of the insolvency, the estimated "gross liability" does not include any amounts for such exposures. This approach has typically been used as the actuarial standards for estimating reserves for asbestos and environmental exposures are in the early stages of development.

And finally, there is not a consistent or typical relationship of the "gross liability" to the ultimate assessments to be levied. This is due to variables such as early access funds received from an insolvent estate, the timing pattern of claim/benefit payments, statutory deposits, investment income, and inter-fund borrowing.

State Differences

One of the unique characteristics of state regulation of insurance is that each state has the authority to regulate in its own way. Accordingly, there are several differences in the various state guaranty association laws which are not recognized in the ED and add further complexity to any attempt to estimate the amount of guaranty association assessments. Such laws determine if assessments are collected for a specific insolvency or a specific account (i.e., auto insurance, life insurance, etc.). This distinction is important because some state laws allow guaranty associations to assess for property/casualty insolvencies by account, not by insolvency. Further, some states may allow intra-account borrowing or transfers of excess funds which could preclude the need for an assessment.

* * * * *

We recognize and appreciate AcSEC's objectives in developing this proposed SOP, which is to provide consistency in the reporting of guaranty association and other assessments. The ED implies that insurers have the ability to reasonably estimate the liability for all such amounts. In the case of guaranty association assessments, however, an insurance enterprise, or any other enterprise subject to such assessments, can estimate its probable liability only when certain assumptions have been provided. The insurer is not in a position to have the necessary information to make those assumptions, nor is there a mechanism currently in place (particularly for property/casualty insolvencies) to provide that information. Further, due to the differences in various state guaranty association laws, there is not a standard approach that would produce reliable, consistent estimates of guaranty association assessments.

We would like to thank AcSEC for this opportunity to respond to this ED and for considering our comments. This is an extremely complex topic that affects a significant number of financial statement preparers and users. For those of us who are closest to the issues, the ED appears to impose a standard which we believe is not attainable. Accordingly, we would welcome an opportunity to review these comments with you or answer any questions you may have. Please feel free to call any one of us to schedule a meeting or to discuss any questions.

Sincerely,

Dale Stephenson
President, NCIGF

Paul A. Peterson, CPA, FLMI
Vice President, Accounting & Finance, NOLHGA

Mark Femal, CPA, CPCU
Executive Director, WI. Ins. Security Fund
Member, NOLHGA Accounting Issues Committee
Chair, NCIGF Subcommittee on Financial Reporting

Charles Renn
Administrator, MO. L&H Ins. Guaranty Association
Chair, NOLHGA Accounting Issues Committee

ATTACHMENT

This attachment provides more detailed comments on issues contained in the ED, Proposed Statement of Position, *Accounting By Insurance and Other Enterprises for Guaranty-Fund and Certain Other Insurance-Related Assessments.*

Issue 1 If adopted, this SOP should apply to any enterprise subject to assessment.

Issue 2 We are not aware of other assessments or transactions which should be subject to this SOP, nor should any be excluded that are correctly included.

Issue 3 Based upon the provisions of the Post-Assessment Guaranty Fund Model Act, the writing of the premium is the appropriate event to trigger the liability for prospective-based premium assessments. While it could be argued that the failure to accrue the ultimate liability ignores the "going concern" concept at the date of insolvency, the proposed approach results in a better matching of the obligation with the period in which the triggering event (i.e., the writing of premium) occurs. However, in cases where the liability is not estimable, disclosure should be require.

Issue 4 Discounting should be permitted, however, the likelihood of meeting the conditions precedent to applying the discounting will be rare.

Issue 5 The proposed method of transition is appropriate.

Issue 6 The proposed effective date may not be appropriate if the NCIGF is required to put procedures in place in order to provide data to enterprises subject to assessment.

The following comments are by paragraph number:

Para. 1 The sentence beginning "Furthermore, the methods..." should be replaced with the following: "Insurance enterprises account for assessments on a pay-as-you-go.(cash basis) or on an accrual basis."

Para. 3 The first sentence should be revised to read: "All states have...". Insert before the third sentence: "The assessments are based upon certain covered lines of business." This change is necessary to reflect that only certain lines of business have guaranty association coverage.

ATTACHMENT

Para. 4 Recommend the following changes to this paragraph~~: "State guaranty funds use one of a variety of methods for assessing member insurers.~~ This SOP identifies four primary types of guaranty association assessments."

a. Retrospective-premium based assessments. ~~Most state g~~ Guaranty ~~funds~~ associations covering benefit payments of insolvent life, annuity, and health insurance enterprises assess member insurers based on an allocation derived from premiums written or received prior to the year of insolvency. ~~Assessments for a given insolvency are based upon an allocation derived from pre-insolvency premiums and usually are made over several years after the insolvency occurs.~~ Annual assessments generally are limited to an established percentage of a member insurer's average premiums for the three years preceding the insolvency. Amounts greater than the cap can be extended to future years. Also, assessments for a given insolvency may be approved or collected over several years.

b. Prospective-premium based assessments. ~~Most state g~~ Guaranty ~~funds~~ associations covering claims of insolvency property and casualty insurance enterprises assess member insurers based on premiums written after the insolvency. ~~Assessments for a given insolvency usually are made over several years after the insolvency occurs~~. Annual assessments generally are limited to an established percentage of a member insurer's premiums written or received for the year preceding the assessment. Amounts greater than the cap can be collected in future years. Also, assessments for a given insolvency may be approved or collected over several years.

c. Prefunded premium based assessments. At least one state uses this kind of assessment to cover claims of insolvent property and casualty insurance enterprises. This kind of assessment essentially pre-funds the costs of future insolvencies. Assessments are made prior to any particular insolvency and are based on current premium written or received.

d. Administrative assessment. Generally these assessments are a flat (annual) amount per member insurer.

Para. 6 Delete the reference to "state guaranty fund" as an example of a state insurance regulatory body. Guaranty associations are not governmental bodies. Footnote 1 should be revised to the following: "Second-injury funds provide reimbursement to insurance carriers or employers for workers' compensation claims when the cost of a second injury combined with a prior accident or disability is greater than what the second accident alone would have produced. The employer of an injured, handicapped worker is responsible only for the workers' compensation benefit for the most recent injury; the second injury fund would cover the cost of any additional benefits for aggravation of a prior condition or injury. The intent of the fund is to help insure that employers are not made to suffer a greater monetary loss or increased insurance costs because of hiring previously injured or handicapped employees."

Para. 7 The word "fund" should be replaced by the word "association."

ATTACHMENT

Para. 8 — Replace the first sentence with the following: "This SOP applies to all enterprises which are subject to guaranty association and other insurance related assessments."

Para. 12 — Footnote 4 should be included in the body of this paragraph and the second sentence of the footnote revised to be the following: "In most states, there must be a final order of liquidation and a finding of insolvency by a court of competent jurisdiction."

Para. 15 — Some examples are needed to illustrate the types of assessments.

Para.16/17 — The assumptions inherent in these paragraphs are numerous. Unless a specific mechanism is established for estimation of a liability by NOLHGA and NCIGF, no enterprise would be able to reliably determine an estimate. The SOP indicates that a member insurer can identify the cash flow needs of the guaranty association, the timing of assessments, the projected market share of the insurance enterprise, the ultimate (or net liability) of the guaranty association, the effect of early access to funds, etc. We believe that while the guaranty associations have some of the required data at their disposal, insurance enterprises have the ability to estimate only their respective market share. A requirement of insurance enterprises to estimate a liability without the necessary information would produce an estimate which is of little value.

While the probability standard may be met, we don't believe the "reasonably estimable" standard is. The following problems are inherent in attempting to estimate the liability:

Problem 1 - At the date of insolvency, no entity has an estimate of the net liability. Once a state insurance department takes a possession of a troubled insurer, the guaranty association must determine its liability, if any. In the case of property/casualty insurer insolvencies, it takes approximately 6 to 9 months to get an estimate on case basis reserves. In a life/health/annuity insolvency, the problem is less severe as the entire insolvent insurer's block of business is reviewed. It takes several months, however, to obtain a reasonable estimate of by-state liabilities so that each guaranty association can inform the member insurers of a "gross liability."

Problem 2 - Actuarial standards for estimating asbestos and environmental exposures are generally in the early stage of development. Until standards have been developed and an estimate for such exposures can be determined, the association cannot estimate its liability.

Problem 3 - The determination of liabilities does not have a consistent or typical relationship to the ultimate assessments to be levied. This is due to early access funds received from an insolvent estate, timing pattern of claim/benefit payments, statutory deposits, investment income, and inter-fund borrowing.

Para. 20 — Allowing discounting of the liability (and any offsets) seems to be appropriate. However, NOLHGA and NCIGF will have to assist enterprises in estimating the timing of assessments.

Para. 21 — Footnote 6 should be included in the body of this paragraph.

ATTACHMENT

Para. 22 This paragraph should require disclosure in those instances where the liability is not estimable.

Para. 30 Add the following to the last sentence of the paragraph "...or the state may require an orderly withdrawal from the state during which time the insurance enterprise is subject to assessments on premiums written."

Para. 43 The rationale for the limitation on asset recognition is not logical. It would seem that the asset should be limited in the case of prospective-premium based assessments to the extent that recognition of such assessments is limited to premiums that have already been written or the insurer is obligated to write. Because the all-time liability is recognized for retrospective-premium based assessments, the all-time asset should be recognized, subject to a collectibility allowance.

General Definitions are needed for the following terms: premiums written, premium tax offset, and policy surcharge.

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March 5, 1997

Ms. Elaine M. Lehnert
Technical Manager, Accounting Standards
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Dear Ms. Lehnert:

Travelers welcomes the opportunity to comment on the exposure draft (ED) of the proposed Statement of Position (SOP), *Accounting By Insurance and Other Enterprises for Guaranty-Fund and Certain Other Insurance-Related Assessments* which was released by the Accounting Standards Executive Committee (AcSEC) of the AICPA for public comment. We recognize and appreciate AcSEC's objectives in developing this proposed SOP (i.e., to provide consistency in the reporting of guaranty fund and other assessments). However, there are three areas of the ED which we believe pose significant problems: estimation of the liability by insurers, recognition of an asset, and policy surcharges. These issues are addressed in the body of this letter and, along with other issues, are discussed in more detail in an attachment to this letter.

Estimation of the Liability

The proposed ED adopts an approach to liability recognition which is generally based upon Statement of Financial Accounting Standards No. 5 (FAS 5), *Accounting for Contingencies*, and contains essentially the same conditions precedent to requiring accrual of a liability. Included in these conditions is the requirement that the amount of loss can be reasonably estimated.

In order for an insurance enterprise to estimate an assessment from a state guaranty association, workers' compensation second-injury fund, or other such entity, the insurer would first have to estimate the probable loss of that entity. To do so, would require the insurer to be knowledgable of the circumstances surrounding the loss, including probable courses of action to be taken by the entity in managing the loss, and the probable outcome of those events (and others) would have to be reasonably predictable.

Given the various courses of action that an entity such as a guaranty association may take in managing its losses, the insurer has no knowledge of what actions are likely to be taken nor what the likely impact of those actions would be. This point is demonstrated by looking at past insolvencies. When the gross loss from each insolvency is compared to the net loss that was ultimately assessed to member insurers, there has not been a predictable relationship between the two amounts. The inconsistencies between the gross and net liabilities are caused by such things as the lines of business the insolvent insurer wrote and whether those lines are subject to guaranty fund coverage, whether there are excess assets from the lines that do not have guaranty fund coverage which can be applied to those lines which do, the ability of a guaranty association to use excess assets from the estate of one insolvent insurer to pay for another, the timing of settlements (particularly when the association's delayed settlement results in more investment income), etc.

The most logical source for obtaining the necessary assumptions to estimate a guaranty fund liability would be from organizations such as the National Organization of Life Health Guaranty Associations (NOLHGA) and National Conference of Insurance Guaranty Funds (NCIGF). NOLHGA currently contracts with independent accounting firms to estimate the guaranty-fund cost of insolvencies. NCIGF currently has no such process in place. This difference is primarily due to the contractual differences between policies with life/health policyholders and those with property/casualty policyholders. In the case of life/health policies, the contractual terms and obligations of the insolvent insurer are generally fixed. For property/casualty insurers, the obligation to policyholders is less certain, particularly where there are asbestos and environmental exposures. In fact, for those property/casualty insolvencies that have occurred to date, the guaranty associations involved have not included amounts for asbestos and environmental exposures in the related assessments.

Unless guaranty fund associations and other assessing entities are able to reasonably estimate their losses, insurance enterprises and others subject to assessment are not in a position to reasonably estimate the assessments from those entities. In light of these limitations, we encourage AcSEC to meet with representatives of NOLHGA, NCIGF, and other assessing entities to gain a better understanding of the issues involved in such assessments.

Asset Recognition

Asset recognition is discussed primarily in paragraph 21, while paragraph 43 discusses the rationale for the conclusion in paragraph 21. Footnote 6 limits asset recognition by property/casualty insurers to an amount which is based on premiums that have already been written. We believe that footnote 6 should be included in the body of paragraph 21 and paragraphs 21 and 43 should be revised.

Paragraph 43, as it is currently drafted, can be misleading as it does not contain the limitations contained in footnote 6 and would result in the overstatement of assets for prospective-premium-based assessments and understatement of assets related to retrospective-premium-based assessments. The paragraph states that the amount of the asset should be limited to expected future premiums related to policies in force at the measurement date. For prospective-premium-based assessments, this approach applied verbatim would result in the liability being based upon the amount of premiums written (including the premiums the insurer is obligated to write) while the asset would be based upon both premiums written and expected to be written on policies in force at the measurement date. For retrospective-premium-based assessments, the liability would be based upon a higher premium amount than would the asset. (See the attachment for recommended language.)

Policy Surcharges

The ED considers all amounts an insurer owes to a state for surcharges as an assessment on the insurer. Insurers, however, view surcharges as an assessment or tax on the policyholder (similar to a sales tax) for which the insurer acts as a collection agent for the state. Under this view, the insurer, as collection agent, collects the surcharge from the policyholder and remits only those amounts collected from policyholders to the state. Accordingly, to the extent an obligation is accrued for payment of the surcharge to the state, full recognition of the receivable from the policyholder is appropriate. Paragraph 21 allows recognition of an asset for policy surcharges but limits the asset to an amount based upon in-force policies for life/health/annuity insurers. As discussed above, footnote 6 to paragraph 21 limits recognition of an asset for property/casualty enterprises related to premiums that have already been written. This approach results in consistency for property/casualty insurers (i.e., both the accrued obligation and asset are based upon premiums that have already been written), but is inconsistent for life/health/annuity insurers. In the case of the latter, the insurer would be required to accrue the full obligation, but the asset would be limited to an amount related to in-force policies.

* * * * *

We would like to thank AcSEC for the opportunity to comment on this ED. This is a complex topic that affects a significant number of financial statement preparers and others. From the perspective of a financial statement preparer, we would agree that there is diversity in current reporting of guaranty fund and other assessments. There will be some assessments that insurers can estimate. However, we do not believe that insurance enterprises (and others subject to assessment) are currently in a position to estimate the obligations of the assessing entities for the reasons discussed above. Because the accounting guidance contained in the ED does not overcome insurers' current inability to estimate the liabilities of the assessing entity, we do not believe the ED would accomplish its objective in the near future, i.e., conformity of reporting. For these reasons, we would encourage AcSEC to meet with the various affected organizations to gain a better understanding of the issues involved before proceeding with the ED.

We would welcome an opportunity to review these comments with you or answer any questions you may have. Please feel free to call me.

Sincerely,

Paula C. Panik

Paula C. Panik

Attachment

This attachment provides more detailed comments on issues contained in the ED, Proposed Statement of Position, *Accounting By Insurance and Other Enterprises for Guaranty-Fund and Certain Other Insurance-Related Assessments.*

Issue 1 If adopted, this SOP should apply to all enterprises subject to assessment.

Issue 2 We are not aware of other assessments or transactions which should be subject to this SOP. None of the assessments that are included in the SOP should be excluded.

Issue 3 The writing of the premium is the appropriate event to trigger the liability for prospective-based-premium assessments. This approach is consistent with the provisions of the Post-Assessment Guaranty Fund Model Act. In cases where the liability is not estimable, disclosure should be required.

Issue 4 Discounting of the liability and related asset, if any, appears to be appropriate under the conditions discussed in the ED. The probability of those conditions occurring, however, is not likely.

Issue 5 The proposed method of transition is appropriate.

Issue 6 The proposed effective date may not be appropriate if the insurance industry is required to coordinate the implementation of procedures with NCIGF and NOLHGA to estimate the subject liabilities.

The following comments are by paragraph number:

Para. 3 This paragraph should be revised to state that assessments are based upon only those lines of business subject to guaranty fund coverage.

Para. 6 Delete the reference to "state guaranty fund" as an example of a state insurance regulatory body. Guaranty associations are not governmental bodies. Footnote 1 should be corrected to better reflect the purposes of second-injury funds, i.e., to provide reimbursement to insurance carriers or employers for workers' compensation claims when the cost of a second injury combined with a prior accident or disability is greater than what the second accident alone would have produced. The purpose is to ensure that employers are not made to suffer a greater monetary loss or increased insurance costs because of hiring previously injured or handicapped employees.

Para. 7 The word "fund" should be replaced by the word "association." Technically, there are only three states which have "funds." The remaining states all have guaranty fund associations.

Para. 8 Replace the first sentence with the following: "This SOP applies to all enterprises which are subject to guaranty fund and other insurance related assessments."

Para. 12 Footnote 4 should be included in the body of this paragraph and the second sentence of the footnote revised to the following: "In most states, there must be a final order of liquidation and a finding of insolvency by a court of competent jurisdiction."

Para. 15 Some examples are needed to illustrate the types of assessments that are intended.

Para. 16 This paragraph assumes that insurers can estimate the guaranty fund association's loss. This is currently not the case.

Para. 17 This paragraph provides that insurers can obtain information from NOLHGA and NCIGF to assist in the estimation of a liability. While NOLHGA currently uses an independent accounting firm to estimate the liability, NCIGF does not have such a process in place. Further, NCIGF would have additional uncertainties involved in attempting to estimate a liability (e.g., liability for environmental and asbestos exposure). The second sentence of this paragraph states that an insurance enterprise need not be formally notified of an assessment by a guaranty fund to make a reasonable estimate of its share of such costs. If an insurance enterprise is not provided with an estimate of a guaranty fund association's liability, how does it go about determining its (i.e., the insurer's) share of an estimate it does not have?

Para. 20 Allowing discounting of the liability (and any offsets) seems to be appropriate. However, NOLHGA and NCIGF will have to assist enterprises in estimating the timing of assessments.

Para. 21 Footnote 6 should be included in the body of this paragraph; however, the limitation on recognition of an asset which is based on policies-in-force should be deleted. A valuation allowance should be required. It is recommended that paragraph 21 read as follows: When it is probable that a paid or accrued assessment will result in an amount that is expected to be recoverable from premium tax offsets or policy surcharges, an asset should be recorded for that recovery in an amount that is determined based on current laws and projections of future premium collections or policy surcharges ~~from in-force policies~~. The recognition of such assets is to be limited to the extent recognition of the liability for prospective-premium-based assessments is limited to the amount of premium an insurance enterprise has written or is obligated to write. This Statement of Position requires an insurance enterprise to recognize a liability for prospective-premium-based assessments as the premium is written by the insurance enterprise. Accordingly, the expected premium tax offset or policy surcharge asset related to the accrual of prospective-premium-based assessments should be based on, and limited to, the amount of premium the insurer has written or is obligated to write.

For retrospective-based-premium assessments, this Statement of Position requires an insurance enterprise to recognize a liability for such assessments at the time the insolvency has occurred. Accordingly, to the extent that paid or accrued assessments are expected to result in a recoverable in a future period, an asset should be recognized at the time the liability is recorded.

In all cases, the asset shall be subject to a valuation allowance if all or a portion of the asset is more likely than not to be realized. The valuation allowance shall be sufficient to reduce the reported asset to the amount that is more likely than not to be realized.

Para. 22 This paragraph should require disclosure in those instances where the liability is not reasonably estimable.

Para. 30 It is recommended that the following be added to the last sentence of the paragraph ".....or the state may require an orderly withdrawal from the state during which time the insurance enterprise is subject to assessments on premiums written."

Para. 43 This paragraph should be replaced with the following: AcSEC believes that it is appropriate to consider recognition of an asset for premium tax offsets or policy surcharges to the extent that paid or accrued guaranty-fund assessments are expected to result in recoverables from the respective state(s), subject to a valuation allowance. However, to the extent recognition of a liability for prospective-premium-based assessments is limited to the amount of premium an insurance enterprise has written or is obligated to write, AcSEC believes the recognition of a related asset should also be limited. AcSEC considered whether it is appropriate to consider all expected future premiums in establishing recoveries. However, AcSEC concluded that this approach would introduce an inconsistency with AcSEC's decision not to recognize a liability for guaranty-fund and similar assessments that are based on future premiums. Therefore, AcSEC determined that considering all future premiums in evaluating the recoverability of premium tax offsets or policy surcharges is not appropriate in the case of retrospective-premium-based assessments.

General It may be helpful to add a glossary of terms at the end of the SOP. Definitions are needed for certain terms used in the ED. For example, if the term "premiums written" applies to the amount of written premium recorded by an insurer on a statutory basis, the amount is likely to vary significantly between insurers depending on the manner in which the insurer records written premium. Statutory accounting allows certain premiums to be recognized as "written" as premium is billed on an installment basis ("booked-as-billed") or as premium is recorded on an annualized basis ("booked-as-written").

Other terms which should be included in the glossary include: premium tax offsets, policy surcharges, and second-injury funds.

Allstate Insurance Company
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Allstate®
You're in good hands.

March 3, 1997

Ms. Elaine M. Lehnert
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American Institute of Certified Public Accountants
File Reference 3162.AS
1211 Avenue of the Americas
New York, NY 10036-8775

<u>Accounting by Insurance and Other Enterprises for Guaranty-Fund and Certain Other Insurance Related Assessments</u>

Dear Ms. Lehnert:

The Allstate Corporation (Allstate) appreciates the opportunity to comment on the Accounting Standards Executive Committee (AcSEC) of the American Institute of Certified Public Accountants' proposed Statement of Position (SOP), *Accounting by Insurance and Other Enterprises for Guaranty-Fund and Certain Other Insurance-Related Assessments* (the proposed SOP). As Allstate regularly receives both retrospective- and prospective-premium based assessments for its property and casualty insurance enterprises and life and health insurance enterprises, we are very interested in the outcome of the proposed SOP.

Overall, we recognize and support the need for further accounting guidance on accounting for guaranty funds and certain other assessments with the objective of minimizing the diversity in practice that currently exists within the insurance industry and providing for added comparability of financial statements among insurance enterprises. However, for the reasons discussed below, we believe the proposed SOP as drafted, would be difficult to implement for property and casualty assessments, due primarily to the lack of timely and accurate information from which reliably estimated accruals as required by this proposed SOP could be derived. Consequently, the provisions of the proposed SOP could potentially result in the establishment of accruals that are both inaccurate and misleading. More specifically, given the lack of an objective basis upon which to establish the accruals (as outlined herein) for prospective premium-based assessments on property and casualty insurers, we believe the proposed SOP would require a significant amount of management discretion in establishing the prescribed accruals, thereby potentially having the unintended and undesirable impact of further reducing the comparability of financial statements among insurance enterprises.

Summary of Position

Allstate is subject to a variety of assessments for its property and casualty insurance and life and health insurance operations and currently accounts for these assessments on either a pay-as-you-go (cash) basis or an accrual basis, depending on the type of assessment. Allstate has historically accrued certain of these assessments to the extent the objective criteria set forth in Statement of Financial Accounting Standards (SFAS) No. 5, *Accounting for Contingencies*, were met.

The proposed SOP requires that a liability be established for guaranty funds when certain conditions exist. One such factor is that the amount of loss must be reasonably estimable. Several factors must be present to provide an insurance entity with the ability to reasonably and reliably estimate this liability. More specifically, the primary determinants are the market share of the insurance entity to be assessed and the anticipated exposure of each state guaranty association for a particular insolvency. The anticipated exposure to be assessed is also impacted by other factors including the amount of losses of the insolvent company to be covered by the guaranty fund, the timing of payments made by the guaranty fund to claimants, and any other sources of cash available to the guaranty fund.

For property and casualty assessments in particular, the ultimate exposure for insolvencies is impacted by additional factors including, but not limited to, the inherent uncertainty in the estimation of claim liabilities (specifically with respect to asbestos, environmental, and other mass tort exposures), as well as the extended time needed to obtain an estimate of the net liability. Another complication is that accruals related to individual insolvencies are impacted by varying state guaranty association laws and regulations.

Paragraphs 16 and 17 of the proposed SOP provide specific guidance intended to provide insurers with the ability to reliably estimate certain assessment-related liabilities. More specifically, the proposed SOP suggests that insurance enterprises obtain information from organizations such as the National Organization of Life and Health Insurance Guaranty Associations (NOLHGA) for life and health insurance enterprises and the National Conference of Insurance Guaranty Funds (NCIGF) for property and casualty insurance enterprises. Although we believe NOLHGA to be a useful and credible source of information upon which to base anticipated losses, it is important to note that the frequency with which it reports insolvencies is annual and even then only material insolvencies involving multiple states for the life and health insurance industry are reported. In the case of NCIGF, it presently does not have a process to estimate and report information on insolvencies to the property and casualty insurance industry which might be used to reliably estimate the accrual on a timely basis.

Conclusion

Given the complexities involved in the calculation of the ultimate exposure for each state guaranty association and the limited availability of reported industry information, as outlined above, we believe it will be difficult, if not impossible for the property and casualty insurance industry to provide reasonable and reliable estimates of this liability. In contrast, in the life and health insurance industry, a process is already in place to provide estimates of individual insurance company's exposures although certain limitations exist even with this process such as the lack of available information on a quarterly basis and specific information for insolvencies considered to be immaterial.

We recommend that the guidance in the proposed SOP regarding the estimation of guaranty fund assessment liabilities be modified to include alternate methods of estimating these liabilities or that the effective date be delayed until such time as the property and casualty industry can develop processes to allow for the determination of reliable accrual estimates that would be comparable among industry participants.

*****

The attached Appendix summarizes our responses to those issues for which AcSEC has specifically requested comment and are of particular interest to Allstate.

Thank you for your thoughtful consideration of this letter. Please feel free to contact me at (847) 402-2213 if you have any questions or if you would like to discuss any of our comments.

Sincerely,

Samuel H. Pilch

Samuel H. Pilch
Vice President and Controller
The Allstate Corporation

cc: Mr. Thomas J. Wilson
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The Allstate Corporation

Appendix

**Proposed Statement of Position,
Accounting by Insurance and Other Enterprises for Guaranty-Fund and Certain Other Insurance-Related Assessments**

This appendix provides further detail regarding our responses to certain issues for which AcSEC has specifically requested comment on the proposed Statement of Position, *Accounting by Insurance and Other Enterprises for Guaranty-Fund and Certain Other Insurance-Related Assessments* (the proposed SOP) that are of particular interest to Allstate. We believe this appendix to be an integral part of, and should be read in connection with, the accompanying letter dated March 3, 1997.

SCOPE

Issue 1

The proposed SOP would apply to all insurance enterprises (stock and mutual), including life and health insurance enterprises, property and casualty insurance enterprises, assessment enterprises, fraternal benefit societies, reciprocal or interinsurance exchanges, insurance pools (other than public-entity risk pools), syndicates, captive insurance companies, and other enterprises subject to guaranty-fund and certain other insurance-related assessments. In addition, entities that are not insurance enterprises but that self insure against loss or liability and are subject to guaranty-fund and certain other insurance-related assessments are included in the scope of this proposed SOP. Is there any reason to exclude enterprises other than insurance companies from this scope. Will non-insurance enterprises have or be able to obtain sufficient information or data to enable them to apply the provisions of this proposed SOP? Why or why not?

There is no reason to exclude enterprises other than insurance companies from the scope of the proposed SOP. We believe all enterprises subject to insurance related assessments should be treated consistently. With respect to obtaining sufficient information or data to apply the provisions of this proposed SOP, it may be more difficult for non-insurance companies due to the lack of data (i.e., market share, etc.) necessary to estimate a company's share of the overall assessment. We believe that both insurance and non-insurance enterprises will be reliant on third-party estimates of the ultimate exposure of insolvencies (See accompanying letter for additional comments).

<u>Issue 2</u>

This proposed SOP would apply to state- and regulatory-imposed assessments related directly or indirectly to underwriting activities and also to insurance-related assessments imposed by other authorities. Are there transactions that are captured by this scope that should be excluded? Alternatively, are there other assessments or transactions not captured by the scope that should be included?

We believe that the scope of the proposed SOP is appropriate.

PROSPECTIVE-PREMIUM-BASED ASSESSMENTS

<u>Issue 3</u>

Paragraph 19b of the proposed SOP specifies that for prospective-premium-based assessments the event that obligates the member insurer is the writing or renewal of the premiums on which the assessments are expected to be based. Alternatively, the insolvency could be considered the underlying cause of an insurance enterprise's obligation to pay future assessments. Is the writing of the premium the appropriate event to trigger the liability for prospective-based-premium assessments, or would the insolvency be more appropriate? Why or why not?

Yes, we agree the writing of the premium is the appropriate event to trigger that a loss is probable. However, as outlined in our accompanying letter, we strongly believe that it will be difficult for insurance enterprises to reasonably and reliably estimate this liability due to the lack of timely and accurate industry information.

PRESENT VALUE

Issue 4

The proposed SOP allows a liability for assessments to be recorded at its present value by discounting the estimated future cash flows at an appropriate interest rate when the amount and timing of the cash payments are fixed or readily determinable. Should discounting be permitted? Should it be required? Why or why not?

We agree that present value based measurements provide the most representative measure of the economic substance of the obligation. We caution, however, that it may be difficult to obtain information necessary to determine the appropriate period over which the liabilities should be discounted. Currently, The National Organization of Life and Health Insurance Guaranty Associations (NOLHGA) is the only source of data for life and health guaranty fund assessments, which only provides estimated funding schedules for a small percentage of reported insolvencies. In practice, we have found that the actual fundings have been materially different from NOLHGA funding schedules. Also, industry information is currently not available with respect to property and casualty funding schedules. In general, we believe present value based measurements should be permitted, but feel that additional guidance should be provided with respect to determining an "appropriate" discount rate as described in the SOP. Without further guidance, financial statement preparers may use materially different discount rates in similar situations thereby decreasing the comparability of financial statements among insurance enterprises.

TRANSITION

Issue 5

This proposed SOP would require adoption at the beginning of an entity's fiscal year (that is, if the SOP is adopted prior to the effective date and during an interim period other than the first interim period, all prior interim periods should be restated). Would another method of transition be more appropriate?

We agree with the method of transition of the proposed SOP.

EFFECTIVE DATE

Issue 6

This proposed SOP would be effective for financial statements for fiscal years beginning after December 15, 1997, with earlier adoption permitted. Is the effective date appropriate?

We believe that due to the difficulties inherent in estimating these liabilities as outlined in our accompanying letter, the effective date of this SOP should be deferred at least until fiscal years beginning after December 15, 1998. This delay will allow the industry to further develop and refine methods to reliably estimate the ultimate exposures related to assessments on a timely basis which then will enable insurance entities to reasonably and reliably estimate assessment related liabilities.

LifeUSA®

Life USA Holding, Inc.
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March 4, 1997

Ms. Elaine M. Lehnert
Technical Manager
Accounting Standards, File 3162.AS
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

RE: Proposed Statement of Position, "Accounting by Insurance and Other Enterprises for Guaranty-Fund and Certain Other Insurance-Related Assessments"

Dear Ms. Lehnert:

Life USA Holding, Inc. appreciates the opportunity to comment on the proposed Statement of Position (SOP) referenced above. Life USA Holding, Inc. is a national financial services holding and marketing company whose primary wholly-owned subsidiary, LifeUSA Insurance Company (LifeUSA), markets a variety of life insurance and annuity products and is represented by over 130 marketing organizations nationwide.

The following will address specific issues with reference to the applicable paragraphs in the proposed SOP that LifeUSA either strongly agrees or disagrees with. LifeUSA generally agrees with the paragraphs that are not referred to in this letter.

Asset Recognition

The first issue that we would like to address can be found in paragraphs 21 and 43 of the SOP. Paragraph 21 states in part that "an asset should be recorded based on current laws and projections of future premium collections from in-force policies". Paragraph 43 continues on to state that "AcSEC considered whether it is appropriate to consider all expected future premiums in establishing such recoveries. However, AcSEC concluded that this approach would introduce an inconsistency with AcSEC's decision not to recognize a liability for guaranty-fund and similar assessments that are based on future premiums. Therefore, AcSEC determined that considering all expected future premiums in evaluating the recoverability of premium tax offsets or policy surcharges is not appropriate."

When evaluating the recoverability of capitalized assessments, the use of only renewal premiums from in force business ignores the going concern assumption which serves as a cornerstone for the vast majority of GAAP guidance, and instead defers to a "liquidation approach" to a business. The liquidation approach inherently assumes that any estimate of future premiums would be considered unreasonable. In practice, accounting methods assume that a business will have a long life and only when liquidation is imminent will a company actually adopt a liquidation approach to accounting.

LifeUSA's Guaranty Fund Assessment Market Position
LifeUSA is a rapidly growing life insurance and annuity writer. Over the past five years, fixed annuity sales have accounted for approximately ninety percent of LifeUSA's collected premiums. LifeUSA pays assessments based on LifeUSA's share of the total industrywide life insurance and annuity premiums written within the forty-nine states in which LifeUSA is licensed to do business. LifeUSA pays annuity premium taxes in only eight states, of which five allow for guaranty fund credits. States that allow guaranty fund credits allow companies to offset annuity guaranty fund assessments against premium taxes paid on life insurance premiums. For LifeUSA and other companies that also have a large block of annuity premiums, total guaranty fund credits, based upon the assessments paid in states allowing for credits, typically exceed the premium tax liability within the states that allow credits. Also, for companies in a growth position, a substantial portion of premiums are first-year premiums which the proposed SOP does not take into account when discussing the appropriate analysis of the guaranty fund asset. A life insurance company that has a significant amount of in-force life insurance business usually has enough renewal premium to generate premium tax liabilities which allow for a full recovery of guaranty fund credits in the participating states.

How LifeUSA Accounts For The Guaranty Fund Asset
LifeUSA, when analyzing whether or not an assessment represents a capitalizable asset, considers the two following factors-

- Does the current law in the particular state that has assessed for an insolvency allow for premium tax offsets, and
- Within that particular state, can a company determine whether or not the premium tax liability in future years will be high enough to take the assessment credits that would be available.

In determining the premium tax liability for future years, LifeUSA uses conservative premium estimates based upon past history, external market conditions, marketing strategy and new product development. Based on the premium tax estimates and the state specific recovery laws, LifeUSA establishes a guaranty fund asset that accurately reflects credits that LifeUSA expects to be able to use in the future.

The Impact on LifeUSA
The proposed SOP, which only allows the projection of future premiums based on in-force policies, effectively eliminates what LifeUSA considers to be the only way for large annuity writers like LifeUSA to accurately assess whether or not there will be enough premium tax to offset the credits available. By not allowing the use of expected future premiums (permitted by the going concern assumption) to establish the appropriate guaranty fund asset, LifeUSA would be required to expense certain assessments annually which in future years would actually be recoverable via premium tax offsets. In essence, adopting the proposed SOP as it stands places LifeUSA in a position of having to adopt an accounting standard which would consistently be in conflict with the matching principle which serves as a cornerstone for the creation of an accurate GAAP income statement.

Conclusion
LifeUSA respectfully requests AcSEC to further review the original approach chosen to analyze the guaranty fund asset. The recognition of an asset based on current laws and projections of future premium collections from in-force policies not only would have an adverse impact on LifeUSA's balance sheet, but would also produce future income statement fluctuations that users of GAAP financial statements of a publicly traded company generally do not expect. LifeUSA would like to suggest that analysis of the guaranty fund asset could be more accurate if prospective premium estimates were to be based upon reasonable assumptions for future premiums.

Additional Comments
Paragraphs 31 & 32. LifeUSA agrees with the minority viewpoint as stated in paragraph 32. Our company is assessed in a majority of the states based upon the rules of the NAIC Life and Health Insurance Model Act which, when adopted by a state, holds companies liable for the outstanding liability of an insolvency based upon a company's percentage share of total premiums written within a state for the three years preceding a formal determination of an insolvency.

Paragraph 23. LifeUSA strongly agrees with this statement.

Ms. Lehnert, we would like to thank you for providing us with the opportunity to present our opinion on the proposed SOP. This enables us to identify potential problems with the language of the proposed SOP so that we may appropriately recommend changes, as stated above, which will allow us to continue to account for guaranty fund assessments in full accordance with GAAP principles and guidelines.

Sincerely,

Mark A. Zesbaugh
Executive Vice President and
Chief Financial Officer
Life USA Holding, Inc.

CELEBRATING A CENTURY OF INTEGRITY
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March 3, 1997

nysscpa

Elaine Lehnert, Technical Manager
Accounting Standards, File 3162.AS
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Re: Exposure Draft, dated December 5, 1996, of a Proposed Statement of Position, "Accounting By Insurance and Other Enterprises for Guaranty-Fund and Certain Other Insurance Related Assessments"

Dear Ms. Lehnert:

The New York State Society of Certified Public Accountants is pleased to submit its comments on the above-referenced Exposure Draft. The comments were developed by the Society's Financial Accounting Standards Committee and are presented in the Issue sequence listed in the Scope section of the Exposure Draft.

Issue 1 The Committee sees no reason to exclude non-insurance enterprises from the scope of the proposed SOP. When such enterprises are in a similar position to insurance companies with respect to these transactions, they should be required to accrue for such liabilities on the same bases.

Although the Committee does not know what information such entities have for making such accruals, it feels the problem has to be addressed on a case by case basis and making accruals for estimates is a common everyday occurrence.

Issue 2 The Committee suggests the scope should be expanded to include similar contractual arrangements in the private sector. It sees no reason to treat them differently.

Issue 3 Since the liability can be avoided, the Committee does not feel that insolvency is the appropriate event to trigger recognition of liability for prospective based premium based assessments. In this circumstance, the cost of writing future premiums should be matched against future revenue.

Issue 4 The Committee agrees with the provision in the proposed SOP that permits but does not require discounting. A requirement to do so would not be appropriate while FASB is still considering the subject of present value.

Issue 5 The Committee agrees with the requirement of the proposed SOP.

Issue 6 The Committee agrees with the effective date of the proposed SOP.

We hope these comments will be helpful. If you wish to pursue further any of these Issues, please let us know and we will have someone from the Committee contact you.

Very truly yours,

William M. Stocker, III

William M. Stocker, III, CPA
Chair, Financial Accounting
Standards Committee

Walter M Primoff

Walter M. Primoff, CPA
Director, Professional Programs

cc: Accounting and Auditing Committee Chairs

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GEORGE E. PATAKI
Governor

Gregory V. Serio
Acting Superintendent of Insurance

February 26, 1997

Ms. Elaine M. Lehnert, Technical Manager
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, New York 10036-8775

Re: Accounting Standards File 3182.AS

Dear Ms. Lehnert:

Following are comments concerning the Exposure Draft of the Proposed Statement of Position on "Accounting By Insurance and Other Enterprises For Guaranty-Fund and Certain Other Insurance Related Assessments".

Prior to commenting on the detailed questions posed in the accompanying letter to the SOP as well as setting forth certain other comments, I believe it first must be stated that there is a fundamental flaw in the Proposed Statement (specifically as indicated in paragraphs 10a and 11a) which emanates from the fundamental flaw existing in FAS 5, i.e., the "probable" standard existent for the establishment of a liability or the recognition of an impairment of an asset. Considering that "probable" is defined as "likely" and that term would appear to represent a concept of more than 50% probable, FAS 5's theoretical base is not only illogical but causative of skewed financial reporting. The correct conceptual framework should involve an expected value calculation of any sacrifice or impairment of an asset or assets. Under the current protocol, and notwithstanding otherwise existing disclosure requirements, a situation where there is a 49% chance of sacrifice or impairment produces no balance sheet liability while the same situation as defined as likely (e.g., a 51% chance or probability) produces a full liability. A slight increase in the evaluation of probability produces a distortedly large impact on the balance sheet. Under an expected value concept, that is not the case. Where there is a basis for estimating a 49% probability of sacrifice or impairment, there is a liability (or reserve) for 49% of the liability; where that expected value is quantified at 51%, the liability (or reserve) increases marginally.

Specifically as relates to the insurance industry, this difference in conceptual framework is immediately recognizable as concerns the property/casualty industry's late recognition of liabilities for environmental losses and the life industry's similarly late recognition of impairments of its real estate related assets. Only as time passed did it become readily apparent to insurers that the threshold of "probability" had been crossed causing the establishment of huge liabilities and reserves at single points in time. Under an expected value concept, the requisite liabilities and reserves would have been recognized in a more timely fashion. Increases certainly would have occurred but in line with more correct estimations of expected values. In other words, under an expected value concept it is reasonable to assume that at earlier points in time insurers might have underestimated the probability of occurrence (in fact under the current accounting concept they did so) but they would still have estimated a liability above zero and recognized some liability or asset impairment.

Thus, the concepts in the instant SOP, as referred to above, should be reevaluated. I fully recognize that this is not "probable" (pun intended) in light of the fundamental base to GAAP which FAS 5 represents; but, nevertheless, that's what should take place. If its even 1% probable that a guaranty fund or other assessment, or any other event for that matter, will result in a sacrifice of assets then a liability therefor should be established. Of course, it would fall within the auditor's scope to ascertain the accuracy, viability and "fairness" of the company's expected value computation with due consideration to materiality.

As to issue 1, I don't believe there is any reason to exclude non-insurance company entities from the scope unless such entities are not subject to the related assessments. However, I cannot evaluate whether such enterprises will have access to sufficient information since I do not regulate them. It would appear that if they are subject to assessment, they would be able to obtain the requisite information.

Concerning issue 2, I do not see any transactions which are included in the scope which shouldn't be. However, there are assessments which have not been alluded to in the SOP. For instance, aside from the second injury funds there are workers' compensation reopened case funds which assess, generally on a loss payment basis, writers of that line of business. Reopened case funds deal with workers' compensation claims which are reopened after significant periods of time have elapsed post-initial settlement. Liabilities should be established in a manner consistent with that described for second injury funds. Another related matter not dealt with in the SOP for all types of assessments concerns reporting, particularly with relevance to the income statement. Generally, assessments such as the reopened case funds, second injury funds, etc. are statutorily reported as losses. Assessments relevant to expenses of a workers' compensation board are statutorily reported as unallocated loss adjustment expenses. Guaranty fund assessments have been reported as other underwriting expenses. You may wish to consider GAAP income statement classification. The statutory reporting of assessments is currently being considered by the Codification of Statutory Accounting Principles Working Group of the N.A.I.C.

Considering my comments on subsequent issues, I would answer affirmatively to the question posed by issue 3, i.e., it is appropriate to use the writing of premium as an appropriate triggering event.

Relative to issue 4, certain portions of workers' compensation reserves, the line of business to which assessments are most material, are already discounted. Thus, assessment rates applied to a discounted reserve already result in a discounted assessment liability.

Issues 5 and 6 are solely GAAP related matters on which I have no opinion.

Concerning the text of the SOP itself, I might point out that paragraph 4c appears to be referencing the New York Property/Casualty Guaranty Fund. You may wish to further describe the fund considering the minimum and maximum levels of fund accumulation which trigger or halt assessments. This goes to the issue of expected value and probability of assessment. For several years that fund made regular assessments; however, no assessments have been levied for the last four to five years due to the fund's balance exceeding the assessment threshold.

As alluded to above, paragraph 6 should also refer to reopened case funds as should paragraph 10.

Paragraph 11, as well as paragraph 19a, should perhaps be reconsidered to deal with the matter of incurred insolvencies which haven't been acknowledged as yet. It is possible to construct a data base which would model insolvency occurrence much like property/casualty losses are modeled to project incurred but not reported reserves. To the degree such models prove credible, then it could be argued that companies should reserve for assessments forthcoming from undetected insolvencies.

In paragraph 16, the last sentence refers to the establishment of the "minimum" amount in a range of estimates when no amount within a range proves a better estimate than any other. This is patently absurd regardless of FAS 5. Clearly, the expected value of the range of the estimates is the most appropriate amount to be established (i.e., the mid-point or mean average).

Paragraph 20 refers to discounting of the liability established for assessments. However, a good portion of such liability will pertain to workers' compensation related assessments. Since such assessments are generally loss-based and the loss base includes discounted loss reserves, those assessments are already effectively discounted. Paragraph 20 should be clear on this issue. I don't believe the comments in paragraph 22 address this precise matter.

Paragraph 21 refers to the asset allowed for premium tax credits emanating from assessments. With reference to assessments based on premium writings, such offsets may not be ultimately realized just as all premium writings are not treated as earned. If premiums are earned ratably, shouldn't premium tax credit assets be established in a consistent manner, i.e., recognize an asset based only on the portion of premium writings already earned? By the way, this matter caused a considerable problem in at least one jurisdiction when premium tax offsets occurred due to initially high premium writings which were subsequently reduced by retrospective premium credits (in fact after the premium tax credits had been used to offset subsequently levied premium taxes). I believe the jurisidiction sought return of the premium tax offset utilized by the company involved.

If you have any questions or wish to discuss these matters, please let me know. My telephone number is 212-602-0316.

Very truly yours,

Martin F. Carus
Assistant Deputy Superintendent
and Chief Examiner
Financial Condition Life Bureau

ARTHUR ANDERSEN

Arthur Andersen LLP

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March 5, 1997

Ms. Elaine M. Lehnert
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File 3162.AS
AICPA
1211 Avenue of the Americas
New York, New York 10036-8775

Dear Ms. Lehnert:

We are pleased to have the opportunity to respond to the proposed statement of position (SOP), *Accounting by Insurance and Other Enterprises for Guaranty-Fund and Certain Other Insurance-Related Assessments* (the "ED").

We believe that the scope of the ED is appropriate and that it provides guidance in an area in which practice has been diverse in the past. We believe the ED will promote better, and more consistent, accounting for assessments. Accordingly, we support issuance of the ED as a final SOP. We have a number of editorial suggestions to clarify the ED that our representative on the Insurance Companies Committee will provide.

We would be pleased to discuss our comments with the Task Force or AcSEC at their convenience.

Very truly yours,

Arthur Andersen LLP

Arthur Andersen LLP

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John Alden®
LIFE INSURANCE COMPANY

Gary M. Reach
Vice President
Planning and Taxation

March 5, 1997

Elaine M. Lehnert
Technical Manager
Accounting Standards
File 3162.AS
America Institute of Certified Public Accountants
1211 Avenue of Americas
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Re: Exposure Draft of Proposed Statement of Position
Accounting by Insurance and Other Enterprises for Guaranty-Fund
and Certain Other Insurance-Related Assessments

Dear Ms. Lehnert:

As the vice president of the tax department of John Alden Life Insurance Company (JALIC), I am responsible for the administration and accounting of JALIC's guaranty fund obligations and would like to offer my comments on the above referenced exposure draft. JALIC is a life and health insurance company domiciled in Minnesota with its principal offices located in Miami, Florida. JALIC is a leading provider of comprehensive group health insurance, selling primarily to groups with smaller than 50 employees.

I would first like to commend AcSEC for its efforts to provide accounting guidance for an insurance enterprise's obligation to state guaranty funds.

I have reviewed the exposure draft and agree with the conclusions reached on the accounting methodology proposed for recording an insurance enterprise's obligation for future guaranty fund assessments. In fact, JALIC currently records a liability for future guaranty fund assessments in a manner similar to that described in the exposure draft.

However, JALIC does not agree with the proposed accounting for the recording of the guaranty fund asset as prescribed in paragraph 21 of the exposure draft. According to the exposure draft, an asset should be recorded for guaranty fund assessments which can be recovered as premium tax offsets or policy surcharges. However, the amount to be recovered is to be determined based on current laws and projections of future premium collections or policy surcharges from ***policies in-force***. According to paragraph 43 of the exposure draft, AcSEC concluded that the inclusion of future premiums from new business would be inconsistent with AcSEC's decision not to recognize a liability for prospective-premium based assessments.

While consistency in accounting practices is preferred, it is not necessarily appropriate in all circumstances. For example, under FAS 109 the determination of whether a deferred tax asset is recoverable is unrelated to the event that generated the asset. JALIC believes that the principles of FAS 109 should apply to premium tax offsets since they appear to have characteristics similar to deferred tax assets.

Generally, under FAS 109, a net deferred income tax asset is recorded to the extent that it is more likely than not that such asset will be realized. A valuation allowance is recorded to reduce the gross deferred tax asset to an amount that is more likely than not realizable. In evaluating whether a valuation allowance is needed, all available evidence is considered. In particular, FAS 109 provides that future taxable income must take all factors into consideration, including anticipated changes in the business (see paragraph 26 of FAS 109). For example, a net deferred income tax asset may be established to the extent utilizable against several sources of income, including future taxable income expected to be generated from an enterprise's operations. With certain limits, projected future taxable income may include income expected to be generated from the growth of such operations.

Thus, the criteria used to measure the recoverability of a deferred tax asset under FAS 109 would seem to provide a reasonable parallel to the criteria which could be applied to measure the recoverability of guaranty fund premium tax offsets by allowing insurance companies to consider all future expected premiums, including premiums from new business, to the extent an insurance company reasonably believes that such premiums can be generated.

Thank you for the opportunity to submit my comments on the exposure draft. I hope that you will agree with my position and reconsider the standard proposed for recording an asset for guaranty fund assessments that can be recovered as an offset against an insurance enterprise's premium tax liability.

If you have any questions or require addition information, please call me at (305) 715-3256.

Sincerely,

Gary M. Reach

Gary M. Reach
Vice President - Planning & Taxation

Gmr015.doc

Proposed Statement of Position:
Accounting By Insurance and Other Enterprises for Guaranty-Fund and Certain Other Insurance-Related Assessments

The following comments are offered concerning the exposure draft (ED) of the proposed Statement of Position (SOP), *Accounting By Insurance and Other Enterprises for Guaranty-Fund and Certain Other Insurance-Related Assessments* which was released by the Accounting Standards Executive Committee (AcSEC) of the AICPA for public comment. While the ED is applicable to both insurance enterprises and others subject to assessments, the comments that follow are from the perspective of insurers only. The organizations listed at the end of this paper have assisted in compiling the comments contained herein and agree with the conclusions discussed below:

Estimation of a Liability

The proposed ED adopts an approach to liability recognition which is based upon Statement of Financial Accounting Standards No. 5 (FAS 5), *Accounting for Contingencies*, and requires accrual of a liability when certain conditions are met. Included in these conditions is the requirement that the amount of loss can be reasonably estimated.

For an insurance enterprise to estimate an assessment from a state guaranty association, workers' compensation second-injury fund, or other entity, the insurer would need to be able to estimate the probable loss of that entity. This would require the insurer to be knowledgeable of the assessing entity's probable losses, the courses of action likely to be taken by the entity in managing those losses, and the likely outcome of the actions taken by the entity.

Some of the factors affecting the outcome of an insolvency include such things as the lines of business the insolvent insurer wrote and whether those lines are subject to guaranty fund coverage, whether there are excess assets from the lines that do not have guaranty fund coverage which can be applied to those lines which do, the ability of a guaranty association to use excess assets from the estate of one insolvent insurer to pay for another, the timing of settlements (and the resulting effect on investment income), etc.

As a practical matter, insurers would likely have to rely on data provided by the National Organization of Life Health Guaranty Associations (NOLHGA) and National Council of Insurance Guaranty Funds (NCIGF) in estimating guaranty fund assessments. NOLHGA currently contracts with independent accounting firms to estimate the guaranty-fund cost of insolvencies. NCIGF currently has no such process in place. This difference is primarily due to the contractual differences between policies with life/health policyholders and those with property/casualty policyholders. The contractual terms and obligations of an insolvent life/health insurer are generally fixed. The obligations of a property/casualty insurer are less certain, particularly where there are asbestos or environmental exposures.

As a result, the assessments for property/casualty insolvencies that have occurred to date have not included amounts for asbestos or environmental exposures.

In spite of guaranty associations' efforts to obtain complete and accurate data concerning insolvencies, there is considerable inherent variability in the underlying data provided by receivers of insolvent insurers. Further, guaranty associations generally use cash basis accounting due to the difficulties in obtaining data and estimating their liabilities. It would not be possible for the management of an insurance enterprise to perform sufficient independent analysis of that data to be able to directly represent that such data fairly presents the liabilities of the enterprise. Equally problematic are the examination issues that are certain to arise when independent auditors and state insurance examiners attempt to apply audit and examination procedures to that data.

Until such time as guaranty fund associations and other assessing entities are able to reasonably estimate their losses, insurance enterprises (and others subject to assessment) are not in a position to reasonably estimate the assessments from those entities. If an assessing entity were able to estimate a range of possible outcomes, we believe that accrual of the minimum amount of the range would be appropriate, consistent with FAS 5.

Premium Tax Offsets and Surcharges

With respect to premium tax offsets and surcharges, we believe that there are two problems inherent in the ED: (i) the ED's basis for recognition of an assessment liability and the basis for the related premium tax offset (asset) are not consistent for retrospective-premium-based assessments and (ii) the ED takes the approach that all surcharges are an assessment on the insurer rather than an assessment on the policyholder.

Recognition Basis

Asset recognition is discussed primarily in paragraph 21 and is subject to the limitations contained in footnote 6 of paragraph 21. Paragraph 43 discusses the rationale for the conclusions in paragraph 21. Footnote 6 limits asset recognition by property/casualty insurers to an amount that is based on premiums which have already been written.

We believe that footnote 6 should be included in the body of paragraph 21 and paragraphs 21 and 43 should be revised. As it is currently written (and without the limitations contained in footnote 6), paragraph 43 may be misleading and could result in the overstatement of assets for prospective-premium-based assessments and the understatement of assets for retrospective-premium-based assessments. The paragraph states that the amount of the asset should be limited to expected future premiums related to policies in force at the measurement date. For prospective-premium-based assessments, this approach would result in the liability being based upon the amount of premiums written (including the premiums the insurer is obligated to write) while the asset would be based upon both premiums written and expected to be written on policies in force at the measurement date.

For retrospective-premium-based assessments, the all-time liability would be recognized while the asset would be limited to renewal premiums on in-force business. A more consistent approach would be to recognize an asset to the extent that paid or accrued assessments are expected to result in a recoverable in a future period, subject to a valuation allowance (i.e., similar to the approach taken by Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes*).

Policy Surcharges

The ED takes the approach that policy surcharges are an assessment on insurers. The industry, however, views surcharges as an assessment or tax on policyholders (similar to a sales tax) for which the insurer acts as a collection agent for the state. Under industry's approach, the insurer, as collection agent, collects the surcharge from the policyholder and remits the amounts collected from policyholders to the state. Accordingly, to the extent an obligation is accrued for payment of the surcharge to the state, full recognition of the receivable from the policyholder is appropriate.

Paragraph 21 allows recognition of an asset for policy surcharges but limits the asset to an amount based upon in-force policies for life/health/annuity insurers. As discussed above, footnote 6 to paragraph 21 limits recognition of an asset for property/casualty enterprises related to premiums that have already been written. The approach taken by the ED results in consistency for property/casualty insurers (i.e., both the accrued obligation and asset are based upon premiums that have already been written), but is inconsistent for life/health/annuity insurers. Life/health insurers would be required to accrue the full obligation, but would be limited to recognition of an asset related to only in-force policies.

Conclusion

The ED would require insurers (and others subject to assessment) to estimate their respective share of a liability that, heretofore, guaranty associations and other assessing entities (e.g., second-injury funds) have not been able to reasonably estimate due to the uncertainties involved and the lack of complete and accurate data. Due to these limitations, we do not believe insurers are in a position to comply with the ED.

Before proceeding with the proposed ED, we encourage AcSEC to meet with representatives of NOLHGA, NCIGF, and other assessing entities to gain a better understanding of the issues involved.

The organizations listed below have assisted in compiling the comments contained herein and agree with the conclusions discussed above. Some of these organizations will be commenting separately to AcSEC and will be suggesting specific revisions to the ED to address certain of the issues discussed above.

Organization	**Name**	**Phone Number**

Allstate Insurance Company	Randy Moreau	847-402-2910
Allstate Life Insurance Company	DiAnn Behrens	847-402-7036
Alliance of American Insurance (representing 250 companies)	Stephen Broadie	847-330-8525
American Re-Insurance Co.	Frank Maffa	609-243-4599
C P & P	Stephen Phillips	215-572-7400
Fireman's Fund	Richard G. Warren	415-899-2172
John Hancock Mutual Life	Patrick Smith	617-572-0608
Kemper Insurance Companies	R. B. Stacy	847-362-9542
Kentucky Farm Bureau Insurance	Cindy Matherly	502-495-5000
Liberty Mutual	Frank Robinson	617-357-9500
Loyal American Life Insurance	W. R. Samples	334-470-6506
Travelers Insurance	Paula C. Panik	860-277-7499
Munich American Re	Edward Fischer	212-310-1711
Minnesota Mutual Life Insurance Company	Betty N. Brost	612-225-6373
National Association of Mutual Insurance Companies	William D. Boyd	317-875-5250
Provident Mutual Life Insurance Company	Todd Miller	610-407-1056
National Association of Independent Insurers (representing 570 companies)	Joseph Pomilia	708-297-7800
The Prudential Insurance Company of America	David A. Nachman	201-802-2003

AMERICAN INSURANCE ASSOCIATION
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March 5, 1997

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Ms. Elaine M. Lehnert
Technical Manager
Accounting Standards
File 3162.AS
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775

RE: PROPOSED STATEMENT OF POSITION, ACCOUNTING BY INSURANCE AND OTHER ENTERPRISES FOR GUARANTY-FUND AND CERTAIN OTHER INSURANCE-RELATED ASSESSMENTS

Dear Ms. Lehnert:

American Insurance Association (AIA) is a trade association of more than 300 property-casualty insurance companies. Our members issue insurance policies throughout the United States and the rest of the world and write approximately 24% of the property-casualty insurance premiums in the U.S. The purposes of AIA are to provide a forum for discussion of problems which are of common concern to its members and the public; to keep members informed of regulatory, legislative and judicial developments and to serve the public interest through appropriate activities such as submitting these comments.

The AIA Committee on Financial Management Issues, with assistance from the Workers' Compensation Committee, developed comments to the December 5, 1996 Exposure Draft (ED), with respect to property-casualty insurance, as follows:

RESPONSES TO THE SPECIFIC ISSUES RAISED IN THE ED

The following are the AIA responses to the specific issues raised in the ED:

Issue 1 - Is there any reason to exclude enterprises other than insurance companies from the scope? Will non-insurance enterprises have, or be able to obtain, sufficient information or data to enable them to apply the provision of this proposed SOP? Why or why not?

We believe that all enterprises which are subject to insurance related assessments should be covered by the SOP to insure consistent application. There may be instances when it will be difficult or impossible for either insurance or other than insurance companies to make the estimations required for an accrual, but the estimation process should be applicable to both groups of organizations.

Issue 2 - Are there transactions that are captured by this scope that should be excluded? Alternatively, are there other assessments or transactions not captured by the scope that should be included?

We do not believe that it will be possible for insurers to estimate the probable assessments for guaranty funds and second injury funds, as described more fully below. We believe that assessments paid to bureaus in states which mandate such membership should be excluded from the scope of the SOP because they are generally based upon a contract between the insurer and the bureau and should be accounted for according to the terms of the contract.

Issue 3 - Is the writing of the premium the appropriate event to trigger the liability for prospective-premium-based assessments, or would the insolvency be more appropriate? Why or why not?

We believe that the trigger for prospective-premium-based assessments should be the writing of the premium on which the assessment will be based. We do not believe, however, that it will be possible for insurers to estimate the probable assessments for guaranty funds and second injury funds, as described more fully below.

Issue 4 - Should discounting be permitted? Should it be required? Why or why not?

We have traditionally taken a position opposing discounting of unpaid losses except in those instances where the payments are fixed and reasonably determinable. We believe that discounting should not be mandated by this SOP until FASB addresses present value accounting.

Issue 5 - Would another method of transition be more appropriate? Is the effective date appropriate?

We believe that both the method of transition and effective date described in the proposed SOP are appropriate.

ESTIMATING PROBABLE ASSESSMENTS FOR GUARANTY FUNDS

Paragraph 19a of the proposed SOP indicates that with respect to retrospective-premium-based assessments ". . . an insurance enterprise that has the ability to reasonably estimate the amount of the assessment should recognize a liability for the entire amount of future assessments related to a particular insolvency when a formal determination of insolvency is rendered." Except in the most unusual instances, it will not be possible for an insurance enterprise to estimate ". . . the entire amount of future assessments related to a particular insolvency when a formal determination of insolvency is rendered." If any entity has such an ability, it would be the state guaranty association that is responsible for paying the "covered claims" in the states affected. The National Conference of Insurance Guaranty Funds (NCIGF) is submitting comments that include the difficulties of making such an estimation, so we will not repeat them here. It should be noted, however, that the "entire amount of future assessments" is not the net liability of member insurers. From time to time, including when the estate of an insurance enterprise in liquidation is closed, a liquidator may make distributions of assets to state guaranty associations. These distributions either reduce the amounts of future assessments or are distributed to member insurers in accordance with their previous assessments. At the time of the insolvency, it is extremely unlikely that a liquidator could estimate the amount that will be distributed to state guaranty associations because of the difficulty in estimating the amounts that will be realized from the major assets, which often include reinsurance recoverables and agents balances as well as invested assets. Further, the liquidator would have to estimate the expenses of liquidation, which are often significant.

Paragraph 19b of the proposed SOP indicates that with respect to prospective-premium-based assessments, "An insurance enterprise that has the ability to reasonably estimate the amount of the assessment should recognize a liability when the related premiums are written or when the insurance enterprise becomes obligated to write the premiums." Except in the most unusual instances, it will not be possible for an insurance enterprise to estimate its ". . . liability when the related premiums are written. . . ." If any entity has such an ability, it would be the state guaranty association that is responsible for paying the "covered claims" in the states affected. The NCIGF is submitting comments that include the difficulties of making such an estimation, so we will not repeat them here. It should be noted, however, that most state property-casualty insurance guaranty association assessments are allocated based upon the written premiums of member insurers for the applicable lines (or "accounts") for the previous year. Thus, at the end of the first quarter of any given year, an insurer would be required to estimate all of the assessments that will be levied by the state guaranty associations in all of the affected states in the <u>following</u> calendar year, i.e., as far as 21 months in the future, but only to the extent that the underlying insolvencies have already occurred.

For these reasons, we have indicated in issue 2, above, that we do not believe it will be possible for insurers to estimate the probable assessments for guaranty funds.

ESTIMATING PROBABLE ASSESSMENTS FOR SECOND INJURY FUNDS

Second injury funds are subject to many of the same uncertainties described with respect to state guaranty associations, above. If any entity has the ability to reasonably estimate the amount of future assessments, it would be the state second injury funds. Second injury funds are created by state workers' compensation statutes and are operated by state Workers' Compensation Agencies, not by private insurers. Assessments are imposed on insurance entities by statutory formula to finance the following year's anticipated benefit obligations. Assessments are imposed only when the fund balance falls below the threshold specified in the statute.

In the vast majority of states, insurance entities are reimbursed by second injury funds, although, in a few states, the funds assume a direct obligation to pay the claims. Except in the most unusual instances, it will not be possible for an insurance entity to estimate the amount of future assessments because, generally, second injury funds do not perform actuarial evaluations of incurred costs of claims and insurers cannot predict what their market share will be in future years.

Further, we believe that second injury funds are similar in many respects to reinsurance arrangements and certain involuntary pools that are specifically excluded from the scope of the proposed SOP in paragraph 9.

Also, paragraph 19e of the proposed SOP indicates that for loss-based assessments, ". . . an insurance enterprise that has the ability to reasonably estimate the amount of the assessment should recognize a liability as the related loss occurs." (Emphasis added) Certain administrative-type and second injury fund assessments, however, are based upon paid losses. Therefore, it is inappropriate in such instances for an enterprise to recognize a liability when the related loss occurs. This is analogous to the accounting applicable to claims-made policies, which requires that a liability be recognized when a claim is made rather than the usual requirement that a liability be recognized when the loss is incurred. In both cases, the liability is based upon contractual arrangements that distinguish them from the usual occurrence method of accrual.

For these reasons, we have indicated in issue 2, above, that we do not believe that it will be possible for insurers to estimate the probable assessments for second injury funds. If such estimations are required, however, they should be based upon paid losses, when applicable.

OTHER ASSESSMENTS

Notwithstanding our belief that the SOP should not apply to either state guaranty association or second injury fund assessments, we believe that there are and will continue to be assessments that insurers can reasonably estimate. We believe that accounting prescribed in the proposed SOP is appropriate in those instances, except for loss-based assessments that are based upon paid losses, as described above.

POLICY SURCHARGES

In certain instances, policy surcharges are collected from policyholders and then forwarded to the appropriate entity. In such instances, the insurance entity acts as a collection agency and should reflect a liability to the extent that it has collected surcharges that have not yet been forwarded to the appropriate entity.

PROBLEMS IN UNDERSTANDING PARTS OF THE ED

We believe that parts of the ED are difficult to understand and should be clarified. The following are three examples:

1 Paragraph 6 includes "state guaranty fund" as an example of an "administrative-type" assessment. This is not consistent with paragraphs 10, 11 and 12, which distinguish between "state guaranty fund" and "administrative-type" assessments.

2 The last two sentences in paragraph 8, when combined, indicate that certain " . . . entities other than insurance enterprises . . . are referred to in this SOP as insurance enterprises or member insurers." Perhaps it would be clearer if the SOP indicated that " . . . entities other than insurance enterprises . . . in this SOP are included within the definition of insurance enterprises."

3 Paragraph 19d applies to "other assessments." We assume that this is intended to refer to assessments other than as described in 19 a, b and c. This interpretation is unclear, however, because the text in 19d refers to "'other assessments,' as defined in paragraph 6, . . . " and paragraph 6 includes a description of all types of assessments.

CONCLUSION

Generally, AIA believes that there are and will continue to be assessments that insurers can estimate. We believe that accounting prescribed in the proposed SOP is appropriate in those instances, except for loss-based assessments that are based upon paid losses. We also believe that state guaranty fund and second injury fund assessments cannot be reasonably estimated.

Thank you for this opportunity to express our comments. We would be pleased to respond to any questions.

Sincerely,

Phillip Schwartz

Phillip Schwartz
Vice President
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March 6, 1997

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Proposed Statement of Position
Accounting by Insurance and Other Enterprises
for Guaranty-Fund and Certain Other Insurance-
Related Assessments

Dear Ms. Lehnert:

We concur with the conclusions in the Proposed Statement of Position referred to above and support issuing it. We have the following comments:

Scope

We agree with the scope of the proposed SOP whereby it would be applicable to all companies subject to guaranty-fund and insurance-related assessments. However, we are concerned that the SOP may not clearly convey which non-insurance entities may be affected and in what circumstances. We recommend that the final SOP contain a separate section entitled "Entities other than Insurance Entities" that explains and provides examples of the circumstances that would result in these entities having to apply the SOP. The proposal's current format will make it difficult for non-insurance entities to apply its provisions.

We believe that the most significant assessment that impacts non-insurance entities is that of second injury funds which involves entities that self-insure workers' compensation obligations. Second injury funds generally assess insurance companies and self-insurers based on paid losses and, as such, comparable information is available to non-insurance and insurance entities alike to comply with the SOP. However, we recommend that additional guidance be provided as to how non-insurance entities would calculate the liability. For example, a non-insurance entity may develop an accrual for its second injury liability based on available information such as the ratio of the entity's prior period paid workers' compensation claims to aggregate workers' compensation claims in the state that was used as a basis for previous assessments, total fund assessments in prior periods, and known changes in the current period to either the number of employees self-insured by the entity or number of workers subject to recoveries from the second injury fund that might alter total fund assessments and the entity's proportion of total fund assessments.

Prospective-Premium-Based Arrangements

For prospective-premium based arrangements, we concur that the writing of the premium is the appropriate event to trigger the liability and strongly disagree with the alternative view discussed in the proposed SOP that the insolvency of an insurance company would require the recognition of liability. Paragraph 36 of FASB Statement of Concepts No. 6, provides that one of the three characteristics of a liability is that "the transaction or other event obligating the entity has already happened." Accordingly, for those assessments, we agree that the appropriate event to trigger recognition of the liability is the future writing of the premium, because without that event an entity generally would not have a liability even though a known insolvency is likely to generate assessments from the fund.

Regarding prospective-premium-based arrangements:

- Because paragraph 19b requires the recognition of a liability when the enterprise is "obligated to write" the premium, we suggest that AcSEC better define the term and indicate whether expected cancellations should be considered in determining such future premiums.

- We agree with paragraph 19c that a liability for a prefunded-premium-based-arrangement arises when premiums are written. However, to avoid ambiguity we recommend that the SOP clarify why an asset (e.g., prepaid premiums) should not be recognized until the time of insolvency.

Reporting Assets

Paragraph 21 of the SOP, which discusses recognizing assets for premium tax offsets and policy surcharges, is unclear in correlating assets with the type of insurance enterprise they would be relevant to. For example, paragraph 21 states that asset recognition is normally limited to life and health enterprises whereas footnote 6 is written for property and casualty enterprises.

With regard to valuing the asset, we suggest AcSEC consider adopting similar guidance as included in SOP 96-1, *Environmental Remediation Liabilities*, section 6.22, to require that fair value be used to measure the amount of a potential recovery. This is particularly important when the timing of the recovery of the asset lags from the timing of the payment of the assessment.

Additionally, we suggest that the SOP provide guidance regarding collectibility for insurance companies and other entities that have an amount due from a second injury fund or comparable state insurance fund. We believe recoverables should be limited to the amounts that could be collected based on the funds' current resources. The inclusion of this guidance within the SOP would be particularly relevant in the current environment given the risk that such recoverables may not be collectible due to the current inadequate funding status of some states' second injury funds, especially those that have been funding claims on a "pay as you go basis" using premiums as the assessment base.

Effective Date

We concur with the effective date of the SOP assuming the SOP is finished timely and any concerns of non-insurance entities have been identified and addressed.

We would be pleased to discuss our comments and recommendations with members of the Accounting Standards Executive Committee or its staff.

Sincerely,

Ernst + Young LLP

Coopers & Lybrand

Coopers & Lybrand L.L.P.

a professional services firm

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March 4, 1997

Ms. Elaine Lehnert
Technical Manager, Accounting Standards
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American Institute of Certified Public Accountants
1211 Avenue of the Americas
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Subject: Proposed Statement of Position, *Accounting by Insurance and Other Enterprises for Guaranty-Fund and Certain Other Insurance-Related Assessments*

Dear Ms. Lehnert:

Coopers & Lybrand L.L.P. is pleased to submit our comments on the exposure draft of the proposed Statement of Position (SOP), *Accounting by Insurance and Other Enterprises for Guaranty-Fund and Certain Other Insurance-Related Assessments.* The Accounting Standards Executive Committee of the American Institute of Certified Public Accountants (AcSEC) is to be commended for its efforts to provide guidance on accounting for insurance-related assessments. We believe the proposed SOP will reduce the current diversity in accounting methods for such assessments and enhance the comparability of different insurance enterprises' financial statements.

Overall, we are in agreement with the proposed SOP, and our comments that follow highlight specific recommendations that we have to clarify the document.

Scope

Issue 1: The proposed SOP would apply to all insurance enterprises (stock and mutual), including life and health insurance enterprises, property and casualty insurance enterprises, assessment enterprises, fraternal benefit societies, reciprocal or interinsurance exchanges, insurance pools (other than public-entity risk pools), syndicates, captive insurance companies, and other enterprises subject to guaranty-fund and certain other insurance-related assessments. In addition, entities that are not insurance enterprises but that self insure against loss or liability and are subject to guaranty-fund and certain other insurance-related assessments are included in the scope of this proposed SOP. Is there any reason to exclude enterprises other than insurance companies from the scope? Will non-insurance enterprises have or be able to obtain sufficient information or data to enable them to apply the provisions of this proposed SOP? Why or why not?

We are not aware of any reason to exclude the noninsurance enterprises identified above from the scope of this proposed SOP. We believe that such enterprises will generally have access to the pertinent information upon which such assessments are determined.

Issue 2: This proposed SOP would apply to state- and regulatory-imposed assessments related directly or indirectly to underwriting activities and also to insurance-related assessments imposed by other authorities. Are there transactions that are captured by this scope that should be excluded? Alternatively, are there other assessments or transactions not captured by the scope that should be included?

We agree with the scope of the proposed SOP and are not aware of any other transaction that should be included or excluded from the scope.

Prospective-Premium-Based Assessments

Issue 3: Paragraph 19b of the proposed SOP specifies that for prospective-premium-based assessments the event that obligates the member insurer is the writing or renewal of the premiums on which the assessments are expected to be based. Alternatively, the insolvency could be considered the underlying cause of an insurance enterprise's obligation to pay future assessments. Is the writing of the premium the appropriate event to trigger the liability for prospective-based-premium-based assessments, or would the insolvency be more appropriate? Why or why not?

We agree with the conclusion in paragraph 19b that the writing of premiums is the event that triggers the liability for prospective-premium-based assessments unless the enterprise cannot avoid paying the assessment even if future premium writings are reduced.

Present Value

Issue 4: The proposed SOP allows a liability for assessments to be recorded at its present value by discounting the estimated future cash flows at an appropriate interest rate when the amount and timing of the cash payments are fixed or readily determinable. Should discounting be permitted? Should it be required? Why or why not?

We believe that discounting is appropriate when the cash flows extend beyond one year and are fixed and determinable. However, discounting should not be required until the FASB completes its project on present-value-based measurement.

Currently, there is an inconsistency in the interest rates prescribed in various pronouncements and proposals related to discounting. FAS 113 prescribes an interest rate in paragraph 66 that is "reasonable and appropriate" while the proposed SOP on deposit accounting proposes an interest rate in paragraph 14 that should be based on "the current rate on U.S. Government obligations of a similar duration." We believe the interest rate to be prescribed should follow the FAS 113 approach.

With regard to the discussion in paragraph 21 of the proposed SOP addressing discounting of assets when related liabilities are discounted, we recommend clarifying the last sentence to indicate that it is necessary to use different discount periods when the period of recovery for the assets differs from the pay-out period for the liabilities. Further, even when the liability is not discounted, if the recovery period of the asset is substantially longer than the pay-out period of the obligation, we believe that the proposed SOP should require that the asset be recorded on a discounted basis.

Transition

Issue 5: This proposed SOP would require adoption at the beginning of an entity's fiscal year (that is, if the SOP is adopted prior to the effective date and during an interim period other than the first interim period, all prior interim periods should be restated). Would another method of transition be more appropriate?

No. We agree with the transition requirements as proposed in paragraph 23.

Effective Date

Issue 6: This proposed SOP would be effective for financial statements for fiscal years beginning after December 15, 1997, with earlier adoption permitted. Is the effective date appropriate?

Yes. We do not believe that the proposed effective date will present any undue hardship as most insurers are currently gathering the data upon which such calculations are determined.

Other Comment

In regard to reporting assets for premium tax offsets and policy surcharges, we recommend adding clarifying language regarding the extent to which an asset may be established. Specifically, we suggest adding the following at the end of the first sentence of paragraph 21: "i.e., the amounts of premium tax offsets and policy surcharges are limited to the amounts recoverable over the estimated life of the underlying book of business."

* * * *

We appreciate the opportunity to express our views. If you have any questions regarding our comments, please contact me (201-521-3039) or Stephen J. Lis (201-521-3041).

Very truly yours,

James F. Harrington

James F. Harrington
Director, Accounting and SEC
Technical Services

American Council of Life Insurance

Vincent W. Donnelly
Actuary

March 7, 1997

Ms. Elaine M. Lehnert
Technical Manager, Accounting Standards
American Institute of CPAs
1211 Avenue of the Americas
New York NY 10036-8775

Re: File 3162.AS
Accounting by Insurance and Other Enterprises for Guaranty-Fund and Certain Other Insurance-Related Assessments

Dear Ms. Lehnert:

The Committee on Generally Accepted Accounting Principles (Committee) of the American Council of Life Insurance (ACLI) is pleased to have the opportunity to comment on the exposure draft (ED) of the proposed Statement of Opinion (SOP), *Accounting by Insurance and Other Enterprises for Guaranty-Fund and Certain Other Insurance-Related Assessments*. The ACLI is the major life insurance company trade association, consisting of 557 companies that represent 89 percent of the assets of all U.S. life insurance companies.

The Committee agrees with the AICPA that there is diversity in accounting practice for guaranty-fund assessments among insurers. While we believe existing generally accepted accounting principles provide adequate guidance, the Committee supports the AICPA's attempt through the release of this Statement of Practice to reduce diversity in practice and improve comparability of amounts reported.

Sincerely,

Vince

Vincent W. Donnelly

VWD:jmb

N:\ACTUARIAL\DONN\CGAAP97\AICPA\gtyfundcomm.wpd

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WASHINGTON, D.C. 20004-2599
202/624-2167
FACSIMILE 202/624-2319

ILLINOIS CPA SOCIETY & FOUNDATION

March 5, 1997

Mrs. Elaine M. Lehnert, Technical Manager
Accounting Standards, File 3162.AS
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, New York 10036

Dear Ms. Lehnert:

The Committee on Accounting Principles of the Illinois CPA Society (Committee) is pleased to comment on the Proposed Statement of Position--Accounting by Insurance and Other Enterprises of Guaranty-Fund and Certain Insurance-Related Assessments (SOP), dated December 5, 1996. The organization and operating procedures of the Committee are reflected in the Appendix to this letter. These recommendations and comments represent the position of the Illinois CPA Society rather than any of the members of the Committee and of the organizations with which they are associated. The Committee was assisted in the preparation of these comments by the Illinois CPA Society's Insurance Companies Committee.

Issue 1

We do not believe there is any valid reason to exclude enterprises other than insurance companies from the scope of the SOP. We believe that non - insurance enterprises will be able to obtain sufficient information or data to enable them to apply the provisions of the proposed SOP, as they would have access to the same information or data as is available to insurance companies.

Issue 2

We are not aware of any transactions that would be captured by the scope of the SOP that should be excluded. We are not aware of any assessments or transactions that do not appear to be captured by the scope of the proposed SOP that should be included. However, we believe paragraphs 1 and 6 should be expanded to identify the federal second-injury fund (administered by the Department of Labor) as well as state second-injury funds.

Issue 3

A majority of the Committee believes that the basis for recognizing a liability related to prospective premium-based assessments should be the insolvency of an insurance company for the reasons discussed in paragraph 32, and because once there is a formal determination of insolvency, the criteria in paragraph 10 have been met.

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800-993-0407 (Illinois only)

The majority recognizes that this position would require insurance enterprises that enter a new state or increase market share in a state to accrue a liability for assessments related to an insolvency that occurred before they enter that state or increase their market share. The majority believes that the assessment would be one of the non-deferrable costs associated with entering into a new state or increasing market share. A minority of the Committee agrees with the majority on recognizing a liability due to an insolvency but would defer and amortize the cost for a company newly entering a state.

Another minority within the Committee agrees with the approach in paragraph 19b of the exposure draft.

Issue 4

The Committee believes that an insurance enterprise should discount its liability for future assessments when the amount and timing of the cash payments are fixed or reasonably determinable. A minority believes discounting should only be permitted when the insurance enterprise discounts its policy liabilities.

If discounting is permitted, the SOP should provide some guidance, including an example of how the discounted liability should be determined. Also, the term "readily determinable" (as used in the description of Issue 4) and reliably determinable" (as used in the "summary") should be defined. We believe the better term is "reasonably determinable."

Issue 5

We believe the proposed method of adoption is appropriate.

Issue 6

We believe the proposed effective date is appropriate.

Other comments

In paragraph 10c the word "loss" should be changed to "assessment," so the sentence reads: "The amount of the assessment can be reasonably estimated." Paragraph 11 should be eliminated and "administrative-type assessments that are not loss based" should be included in paragraph 10. At present the only difference between paragraphs 10 and 11 is that paragraph 10 includes the statement "the amount of loss (assessment) can reasonably be estimated," and that should also apply to administrative-type assessments that are not loss based.

Footnote 4 at the bottom of page 15 should be clarified. If an insurance enterprise issues statements showing that its liabilities exceed its assets, it has met the statutory definition of an insolvent insurer. However, the presumption of the probability of an assessment should be based on a determination of the need for an assessment by the state insurance department or a court of competent jurisdiction as a result of an insolvency, not simply the issuance of financial statements showing an entity to be insolvent.

Paragraph 17 should identify the type of information or data to be requested from the guaranty associations to provide the basis for a computation of the estimated liability. It would also be helpful if the SOP included a draft letter requesting such information or data from the guaranty associations and an illustration of how the estimated liability would be computed.

Paragraph 21 should include an example of how to compute the portion of an assessment that is recoverable.

Paragraph 38 should indicate that "incurred losses" include incurred but not reported losses.

We would be happy to discuss our comments and recommendations with you at any time. Please contact Loren B. Kramer, Chair Technical Response Subcommittee, Insurance Companies Committee at 847/432-2250.

Very truly yours,

Wayne J. Shust

Wayne J. Shust
Chair, Committee on Accounting Principles

APPENDIX A

ILLINOIS CPA SOCIETY
ACCOUNTING PRINCIPLES COMMITTEE
ORGANIZATION AND OPERATING PROCEDURES

1996 - 1997

The Accounting Principles Committee of the Illinois CPA Society (the Committee) is composed of 29 technically qualified, experienced members appointed from industry, education and public accounting. These members have Committee service ranging from newly appointed to 15 years. The Committee is a senior technical committee of the Society and has been delegated the authority to issue written positions representing the Society on matters regarding the setting of accounting principles.

The Committee usually operates by assigning a subcommittee of its members to study and discuss fully exposure documents proposing additions to or revisions of accounting principles. The subcommittee ordinarily develops a proposed response which is considered, discussed and voted on by the full Committee. Support by the full Committee then results in the issuance of a formal response, which at times, includes a minority viewpoint.

INSTITUTE of MANAGEMENT ACCOUNTANTS

CERTIFIED MANAGEMENT ACCOUNTANT PROGRAM
CERTIFIED IN FINANCIAL MANAGEMENT PROGRAM

March 12, 1997

Ms. Elaine M. Lehnert
Technical Manager
Accounting Standards - File 3162.AS
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Re: Proposed SOP, "Accounting by Insurance and Other Enterprises for Guaranty-Fund and Certain Other Insurance-Related Assessments"

Dear Ms. Lehnert:

The Financial Reporting Committee ("FRC") of the Institute of Management Accountants is pleased to offer comments on the AICPA's proposed Statement of Position, "Accounting by Insurance and Other Enterprises for Guaranty-Fund and Certain Other Insurance-Related Assessments" (the PSOP"). We agree with the conclusions reached in the PSOP, especially the identification of the triggering events that determine the probability of a liability for the different types of assessments.

The FRC acknowledges that this PSOP has important applications to entities other than insurance companies because those entities self insure against loss or liability. We are concerned that this document may be overlooked by non-insurance companies because of the emphasis of insurance companies in the title of the PSOP. Therefore, we recommend that the AICPA consider revising the title to more clearly emphasis the document's scope.

Our support of the PSOP is based on the specific comments below.

Retrospective-Premium-Based Assessments

We agree that for retrospective-premium based assessments, the trigger for determining the probability of the assessment is when the insolvency occurs. In the case of a retrospective assessment, the assessment is based on premiums written before the insolvency occurs. In this case, we believe that there is a legal basis for establishing an assessment accrual provided that a reasonable estimate or range of estimates for the assessment can be calculated.

Prospective-Premium-Based Assessments

We agree that for prospective-premium-based assessments, the trigger for determining the probability of the assessment is the writing of the premium. In the case of a prospective-premium-based assessment, the assessment is based on the amount of premiums written *after* the insolvency. Until the premiums are actually written, there is no legal basis for assessing member companies, thus such an obligation should not be recorded. Therefore, for prospective-based assessments, a liability cannot be estimated until the assessment has been asserted and billed.

We also agree with the AICPA's findings for prefunded-premium-based assessments, premium-based assessments for other assessments and loss-based assessments.

We have provided our views on each of the issues covered in the PSOP in Attachment A.

The FRC appreciates the opportunity to comment on this proposal. We would be pleased to discuss our comments with you at your convenience.

Sincerely,

Hal Rogero/LB

L. H. Rogero, Jr.
Chairman

frc/comment.aicpa.assess

Attachment A
Responses to Specific Issues Raised in the Proposed SOP

Issue 1: Is there any reason to exclude enterprises other than insurance companies from the scope [of the proposed SOP]?

No. We believe that the conclusions of the SOP should be applied to all types of insurance enterprises as well as any entity that self insures and incurs the same assessments.

Issue 2: Are there transactions that are captured by this scope that should be excluded? Alternatively, are there other assessments or transactions not captured by the scope that should be included?

We believe this SOP should only be applied in situations in which it is clear that the body imposing the assessment has the statutory authority to impose insurance-related assessments and to legally enforce recovery of the assessment.

Issue 3: Is the writing of the premium the appropriate event to trigger the liability for prospective-based-premium-based assessments, or would the insolvency be more appropriate?

Yes, the writing of the premium is the appropriate trigger for prospective-premium-based assessments. If the subject premium is to be written in the future, there would be no legal basis for establishing an accrual prior to production of the written premium.

Issue 4: Should discounting be permitted? Should it be required?

Yes. We believe that discounting should be permitted for any estimated accrued liability. However, we do not believe discounting should be required until the FASB publishes its conclusions on this subject so that such practice would be applied uniformly and consistently by all financial statement preparers.

Issue 5: This proposed SOP would require adoption at the beginning of an entity's fiscal year. Would another method of transition be more appropriate?

No.

Issue 6: The proposed SOP would be effective for financial statements for fiscal years beginning after December 15, 1997, with earlier adoption permitted. Is the effective date appropriate?

Yes.

EXPOSURE DRAFT

**PROPOSED STATEMENT OF POSITION
ACCOUNTING BY INSURANCE AND OTHER ENTERPRISES
FOR GUARANTY-FUND AND CERTAIN
OTHER INSURANCE-RELATED ASSESSMENTS**

Dated: December 5, 1996

Comment date: March 5, 1997

Ms. Elaine M. Lehnert
Technical Manager
Accounting Standards, File 3162.AS
AICPA
1211 Avenue of Americas
New York, NY 10036-8775

Response Prepared by: Accounting and Auditing Standards Committee
Society of Louisiana CPA's

Jim Campbell
Judson J. McCann, Jr.
Jon Flair

Response submitted by: Albert E. Roevens, Jr., Chairman

Issue 1: Entities that are not insurance enterprises but self insure against loss and are subject to guaranty-fund assessments should be included in the scope of this statement of position. If these entities are excluded from this SOP their liabilities would be understated. There may be various ways to obtain this information or prepare estimates.

Issue 3: On this issue the committee members responding have two views.

Two members responding believe that the writing of the premium is the appropriate event to trigger the liability for the potential assessments to be recorded. An estimated provision should be established based on historical information and current economic trends. This estimate should be adjusted for actual losses incurred.

One member responding believes that the alternative view is a more technically supportable position. A liability should be recognized when it is probable that a liability will be incurred upon formal determination of insolvency, and the amount can be reasonably estimated.

Paragraph 20 - Current practice is to allow, but not require, discounting of liabilities to reflect the time value of money when the aggregate amount of the obligation and the amount and timing of the cash payments are fixed or reliably determinable for a particular liability. One of the responding members believes that the statement should consistently apply the application. Another member believes that the liability should be discounted unless immaterial.

1300 South Clinton Street
P.O. Box 7839
Fort Wayne, IN 46801-7839

Tel. 219-455-6244
Fax 219-455-4819

Keith J. Ryan, CPA, FLMI
Vice President & Chief Financial Officer
Financial & Risk Management

LINCOLN LIFE

March 27, 1997

Ms. Elaine Lehnert, Technical Manager
Accounting Standards Division, File 3162.AS
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036-8775

Subject: Proposed Statement of Position on Accounting by Insurance and Other Enterprises for Guaranty Fund and Certain Other Insurance Type Assessments

Dear Ms Lehnert:

We have reviewed the proposed Statement of Position (SOP) referred to above. In general, Lincoln National Corporation supports the SOP, but we respectfully submit the following comments and recommendations:

Use of Present Value Concepts
We believe the discounting of future assessment liabilities should not be an option. One of the goals of the SOP, as stated in Paragraph 2, is "to reduce diversity in practice...by insurance enterprises". Allowing companies to choose whether or not discount future assessments would promote, rather than reduce, diversity in accounting practice.

Additionally, Paragraph 20 of the SOP allows for the discounting of a future assessment liability when the amount **and** the timing of payments is known. It is our opinion that the information provided to life insurers by the National Organization of Life and Health Guaranty Associations may not rise to the level of certainty that would allow discounting under this Paragraph.

Finally, if an insurer elects to discount its future assessment liability, it seems appropriate that they would also be required to discount the related premium tax offset generated when assessment payments are made. We believe that the timing of these offsets can be uncertain, which will lead to further measurement difficulties. In light of these concerns, we suggest that companies should not be given the option to discount these liabilities or the related premium tax offset assets.

Reporting Assets for Premium Tax Offsets
Paragraph 21 of the SOP states that premium tax offset recoverability is determined "based on current laws and projections of future premium collections...from in-force policies". We believe this position is in direct conflict with ARB43, Chapter 3A, Paragraph 2 which reads in part:

- "It should be emphasized that financial statements of a going concern are prepared on the assumption that the company will continue in business."

The determination of premium tax offset recoverability should be based upon the same going concern assumption which underlies an insurance company's financial statement presentation. The going concern concept assumes that while an insurer will lose some business due to lapsing of premiums, these premiums will be replaced by new business written. By limiting the tax offset recoverability testing to in-force policies only, the SOP ignores going concern principles. We believe it would be more appropriate to allow insurers to use reasonable going concern assumptions when determining premium tax offset recoverability.

We would be pleased to discuss our comments and recommendations with members of the Accounting Standards Executive Committee or its staff.

Sincerely,

Keith J. Ryan

Keith J. Ryan, CPA, FLMI
Vice President & Chief Financial Officer

cc: Richard C. Vaughan, Chief Financial Officer, Lincoln National Corporation
Andrew R. Creighton, Appointed Actuary, Lincoln National Reinsurance
Casey J. Trumble, Director of Taxes, Lincoln National Corporation

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EXPOSURE DRAFT

PROPOSED STATEMENT OF POSITION

ACCOUNTING BY INSURANCE AND OTHER ENTERPRISES FOR GUARANTY-FUND AND CERTAIN OTHER INSURANCE-RELATED ASSESSMENTS

DECEMBER 5, 1996

Prepared by the Accounting Standards Executive Committee
American Institute of Certified Public Accountants

Comments should be received by March 5, 1997, and addressed to
Elaine M. Lehnert, Technical Manager,
Accounting Standards, File 3162.AS
AICPA, 1211 Avenue of the Americas, New York, NY 10036-8775
or via the Internet to ELEHNERT@AICPA.ORG

800106

Any individual or organization may obtain one copy of this document without charge until the end of the comment period by writing to the AICPA Order Department, Harborside Financial Center, 201 Plaza Three, Jersey City, NJ 07311-3881.

December 5, 1996

Accompanying this letter is an exposure draft of a proposed Statement of Position (SOP), *Accounting by Insurance and Other Enterprises for Guaranty-Fund and Certain Other Insurance-Related Assessments.* A summary of the significant provisions of the proposed SOP is included in the forepart of that document.

The purpose of the exposure draft is to solicit comments from preparers, auditors, and users of financial statements and other interested parties. AcSEC invites comments on all matters in the proposed SOP and particularly on the following specific issues. Respondents need not comment on all of the issues and are encouraged to comment on additional issues. Respondents should refer to specific paragraph numbers and include reasons for any suggestions or comments.

Scope

Issue 1: The proposed SOP would apply to all insurance enterprises (stock and mutual), including life and health insurance enterprises, property and casualty insurance enterprises, assessment enterprises, fraternal benefit societies, reciprocal or interinsurance exchanges, insurance pools (other than public-entity risk pools), syndicates, captive insurance companies, and other enterprises subject to guaranty-fund and certain other insurance-related assessments. In addition, entities that are not insurance enterprises but that self insure against loss or liability and are subject to guaranty-fund and certain other insurance-related assessments are included in the scope of this proposed SOP. Is there any reason to exclude enterprises other than insurance companies from the scope? Will non-insurance enterprises have or be able to obtain sufficient information or data to enable them to apply the provisions of this proposed SOP? Why or why not?

Refer to paragraph 8.

Issue 2: This proposed SOP would apply to state- and regulatory-imposed assessments related directly or indirectly to underwriting activities and also to insurance-related assessments imposed by other authorities. Are there transactions that are captured by this scope that should be excluded? Alternatively, are there other assessments or transactions not captured by the scope that should be included?

Refer to paragraph 9.

Prospective-Premium-Based Assessments

Issue 3: Paragraph 19b of the proposed SOP specifies that for prospective-premium-based assessments the event that obligates the member insurer is the writing or renewal of the premiums on which the assessments are expected to be based. Alternatively, the insolvency could be considered the underlying cause of an insurance enterprise's obligation to pay future assessments. Is the writing of the premium the appropriate event to trigger the liability for prospective-based-premium-based assessments, or would the insolvency be more appropriate? Why or why not?

Refer to paragraphs 30-37 for the basis for AcSEC's conclusions.

Present Value

Issue 4: The proposed SOP allows a liability for assessments to be recorded at its present value by discounting the estimated future cash flows at an appropriate interest rate when the amount and timing of the cash payments are fixed or readily determinable. Should discounting be permitted? Should it be required? Why or why not?

Refer to paragraph 40 for the basis for AcSEC's conclusions.

Transition

Issue 5: This proposed SOP would require adoption at the beginning of an entity's fiscal year (that is, if the SOP is adopted prior to the effective date and during an interim period other than the first interim period, all prior interim periods should be restated). Would another method of transition be more appropriate?

Refer to paragraph 23.

Effective Date

Issue 6: This proposed SOP would be effective for financial statements for fiscal years beginning after December 15, 1997, with earlier adoption permitted. Is the effective date appropriate?

Refer to paragraph 23.

Responses should be addressed to Elaine Lehnert, Technical Manager, Accounting Standards, File 3162.AS, American Institute of Certified Public Accountants, 1211 Avenue of the Americas, New York, NY 10036-8775, in time to be received by March 5, 1997. Responses also may be sent by electronic mail over the Internet to ELEHNERT@AICPA.ORG.

Written comments on this exposure draft will become part of the public record of the AICPA and will be available for public inspection at the AICPA library for one year after March 5, 1997.

Sincerely,

G. Michael Crooch, CPA
Chair
Accounting Standards
Executive Committee

Robert W. Granow, CPA
Chair
Assessments Task Force

Jane B. Adams, CPA
Director
Accounting Standards

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AICPA Staff

Jane B. Adams
Director
Accounting Standards

Elaine M. Lehnert
Technical Manager
Accounting Standards

SUMMARY

This proposed Statement of Position (SOP) would provide guidance on accounting by insurance and other enterprises for guaranty-fund and certain other insurance-related assessments. The SOP provides:

- Guidance for determining when an insurance enterprise should recognize a liability for guaranty-fund and other assessments.
- Guidance on how to measure the liability and allows for the discounting of the liability, if the amount and timing of the cash payments are fixed and reliably determinable.
- Criteria for when an asset may be recognized for a portion or all of the assessment liability or paid assessment that can be recovered through premium tax offsets or policy surcharges.
- Requirements for disclosure of certain information.

This SOP would be effective for financial statements for fiscal years beginning after December 15, 1997. Early adoption is encouraged. Previously issued annual financial statements should not be restated. Initial application of this SOP should be as of the beginning of an entity's fiscal year (that is, if the SOP is adopted prior to the effective date and during an interim period other than the first interim period, all prior interim periods should be restated). Insurance enterprises should report the effect of initially adopting this SOP in a manner similar to a cumulative effect of a change in accounting principle (refer to paragraph 20 of Accounting Principles Board [APB] Opinion No. 20, *Accounting Changes*).

TABLE OF CONTENTS

FOREWORD

The accounting guidance contained in this document has been cleared by the Financial Accounting Standards Board (FASB). The procedure for clearing accounting guidance in documents issued by the Accounting Standards Executive Committee (AcSEC) involves the FASB reviewing and discussing in public board meetings (1) a prospectus for a project to develop a document, (2) a proposed exposure draft that has been approved by at least ten of AcSEC's fifteen members, and (3) a proposed final document that has been approved by at least ten of AcSEC's fifteen members. The document is cleared if at least five of the seven FASB members do not object to AcSEC undertaking the project, issuing the proposed exposure draft or, after considering the input received by AcSEC as a result of the issuance of the exposure draft, issuing the final document.

The criteria applied by the FASB in their review of proposed projects and proposed documents include the following.

1. The proposal does not conflict with current or proposed accounting requirements, unless it is a limited circumstance, usually in specialized industry accounting, and the proposal adequately justifies the departure.

2. The proposal will result in an improvement in practice.

3. The AICPA demonstrates the need for the proposal.

4. The benefits of the proposal are expected to exceed the costs of applying it.

In many situations, prior to clearance, the FASB will propose suggestions, many of which are included in the documents.

STATEMENT OF POSITION

ACCOUNTING BY INSURANCE AND OTHER ENTERPRISES FOR GUARANTY-FUND AND CERTAIN OTHER INSURANCE-RELATED ASSESSMENTS

INTRODUCTION

1. Insurance enterprises are subject to a variety of assessments, including those by state guaranty funds and workers' compensation second-injury funds. Some entities other than insurance enterprises may be subject to insurance-related assessments because they self insure against loss or liability. This SOP refers to all entities that are subject to guaranty-fund and other insurance-related assessments as insurance enterprises or member insurers. Current accounting practice by insurance enterprises for assessments and related recoveries is diverse. Some of the diversity is a result of fundamental differences in the methods for assessing insurers. However, similar assessments are not being accounted for comparably among insurance enterprises. Some insurance enterprises account for assessments on a pay-as-you-go (cash) basis, whereas others account for assessments on an accrual basis. Furthermore, the methods for accrual are varied. Some insurance enterprises recognize a liability for the entire portion of the estimated cost of an insolvency at the time of the insolvency. Yet others recognize a liability related to assessments that are dependent on the writing of future premiums as those premiums are written. This Statement of Position (SOP) provides guidance on accounting by insurance enterprises for guaranty-fund and certain other insurance-related assessments.

2. As the prevalence and magnitude of guaranty-fund and other assessments have increased, concern about the diversity in practice also has increased. This SOP was undertaken to reduce diversity in practice, improve comparability of amounts reported, and improve disclosures made by insurance enterprises with respect to guaranty-fund and other assessments.

BACKGROUND INFORMATION

Guaranty-Fund Assessments

3. Most states have enacted legislation establishing guaranty funds. The state guaranty funds assess insurance enterprises licensed to sell insurance in the state (member insurers) to provide for payment of covered claims or to meet other insurance obligations, subject to prescribed limits, of insolvent insurance enterprises. Most state guaranty funds assess member insurers for costs related to a particular insolvency after the insolvency occurs. At least one state, however, assesses member insurers prior to insolvencies.

4. State guaranty funds use a variety of methods for assessing member insurers. This SOP identifies three primary types of guaranty-fund assessments.

a. <u>*Retrospective-premium-based assessments*</u>. Most state guaranty funds covering benefit payments of insolvent life and health insurance enterprises assess member insurers based on premiums written *prior* to the insolvency. Assessments for a given insolvency are based on an allocation derived from pre-insolvency premiums and usually are made over several years after the insolvency occurs. Annual assessments generally are limited to an established percentage of a member insurer's average premiums for the three years preceding the insolvency.

b. *Prospective-premium-based assessments*. Most state guaranty funds covering claims of insolvent property and casualty insurance enterprises assess member insurers based on premiums written *after* the insolvency. Assessments for a given insolvency usually are made over several years after the insolvency occurs. Annual assessments generally are limited to an established percentage of a member insurer's premiums for the year preceding the assessment.

c. *Prefunded-premium-based assessments*. At least one state uses this type of assessment to cover claims of insolvent property and casualty insurance enterprises. This type of assessment is intended to prefund the costs of future insolvencies. Assessments are made prior to any particular insolvency and are based on the current level of written premiums of the member insurer. Rates to be applied to future premiums are adjusted as necessary.

5. State laws often allow for recoveries of guaranty-fund assessments by member insurers through such mechanisms as premium tax offsets, policy surcharges, and future premium rate structures.

Other Assessments

6. Insurance enterprises are subject to a variety of other assessments. Many states have established other funds supported by assessments on member insurers. The most prevalent uses for such assessments are (a) to fund operating expenses of state insurance regulatory bodies (for example, the state insurance department, state guaranty fund, or workers' compensation board), referred to as administrative-type in this SOP, and (b) to fund second-injury funds.[1]

7. The primary methods used to assess member insurers for these other assessments are–

a. *Premium-based assessments*. Generally the fund will apportion the assessment based on the member insurer's written premiums.[2] The base year of premiums may be the current year or the year preceding the assessment.

b. *Loss-based assessments*. Generally the fund will apportion the assessment based on the member insurer's incurred losses or paid losses in relation to that amount for all member insurers in the particular jurisdiction.

SCOPE

8. This SOP applies to all insurance enterprises (stock and mutual), including life and health insurance enterprises, property and casualty insurance enterprises, title insurance enterprises, mortgage guaranty insurance enterprises, assessment enterprises, fraternal benefit societies, reciprocal or interinsurance exchanges, insurance pools (other than public-entity risk pools), syndicates, and captive insurance companies. In addition, this SOP applies to entities other than insurance enterprises that are subject to insurance-related assessments because they self insure

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[1] Second-injury funds provide reimbursement to insurance carriers or employers for workers' compensation claims related to a second injury. Second-injury funds protect employers from having to pay a larger cost for an employee's injury when that injury combined with a prior accident or disability is greater than what the second accident alone would have produced. The intent of the fund is to help insure that employers are not made to suffer a greater monetary loss or increased insurance costs because of hiring previously injured employees.

[2] These assessments may also be applied at the county, municipality, or other such level.

against loss or liability.[3] Such entities are referred to in this SOP as insurance enterprises or member insurers.

9. Assessments covered by this SOP include any charge mandated by statute or other regulatory authority that is related directly or indirectly to underwriting activities, except for income taxes and premium taxes. This SOP does not apply to amounts payable or paid related to reinsurance contracts or arrangements that are in substance reinsurance, including assumed reinsurance activities and certain involuntary pools that are covered by Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 113, *Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts.*

CONCLUSIONS

Reporting Liabilities

10. Insurance enterprises should recognize liabilities for guaranty-fund, second-injury fund, and loss-based administrative-type assessments when all of the following conditions are met:

a. An assessment has been asserted or information available prior to issuance of the financial statements indicates it is probable that an assessment will be asserted.

b. The underlying cause of the asserted or probable assessment has occurred on or before the date of the financial statements.

c. The amount of loss can be reasonably estimated.

11. Insurance enterprises should recognize liabilities for administrative-type assessments that are not loss based when all of the following conditions are met:

a. An assessment has been asserted or information available prior to issuance of the financial statements indicates it is probable that an assessment will be asserted.

b. The underlying cause of the asserted or probable assessment has occurred on or before the date of the financial statements.

12. *Probability of Assessment*. For premium-based guaranty-fund assessments, except for prefunded guaranty-fund assessments, it is presumed to be probable that a member insurer will be assessed when a formal determination of insolvency occurs.[4] For prefunded guaranty-fund assessments and premium-based administrative-type assessments (as defined in paragraph 6), it is presumed to be probable that a member insurer will be assessed when the premiums on which the assessments are expected to be based are written. For administrative-type and second-injury funds that are funded by loss-based assessments, it is assumed to be probable that a member

[3] For example, one state specifies that self-insurers of workers' compensation should use as a base for assessment the amount of premium the self-insurer would have paid if it had insured its liability with an insurer for the previous calendar year.

[4] For purposes of this SOP, a formal determination of insolvency occurs when a member insurer meets a state's (ordinarily the state of domicile of the insolvent insurer) statutory definition of an insolvent insurer. In most states, the member insurer must be declared to be financially insolvent by a court of competent jurisdiction. In some states, there must also be a final order of liquidation.

insurer will be assessed when the losses on which the assessments are expected to be based are incurred.

13. *Underlying Cause*. Because of the fundamental differences in how assessment mechanisms operate, the event that makes it probable that an assessment will be made (for example, an insolvency) may not be the event that obligates a member insurer. The following defines the event that is the underlying cause that obligates a member insurer to pay an assessment for each type of assessment defined in this SOP.

14. For premium-based assessments, the event that obligates the member insurer is a member insurer's writing the premiums or becoming obligated to write or renew (such as multiple-year, noncancelable policies) the premiums on which the assessments are expected to be based. Some states, through law or regulatory practice, provide that an insurance enterprise cannot avoid paying a particular assessment even if that insurance enterprise reduces its premium writing in the future. In such circumstances, the event that obligates the member insurer is a formal determination of insolvency.

15. For loss-based assessments, the event that obligates a member insurer is a member insurer's incurring the losses on which the assessments are expected to be based.

16. *Ability to Reasonably Estimate the Liability*. One of the conditions in FASB Statement No. 5, *Accounting for Contingencies,* for recognition of a liability is that the amount can be reasonably estimated. FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss*, provides that some amount of loss can be reasonably estimated when information available indicates that the estimated amount of loss is within a range of amounts. When no amount within the range is a better estimate than any other amount, the minimum amount in the range shall be accrued.

17. Insurance enterprises can obtain information to assist in estimating the total guaranty-fund cost or the following years' assessments (as appropriate) for an insolvency from organizations such as the National Organization of Life and Health Insurance Guaranty Associations (NOLHGA) and the National Conference of Insurance Guaranty Funds (NCIGF). An insurance enterprise need not be able to compute the exact amounts of the assessments or be formally notified of such assessments by a guaranty fund to make a reasonable estimate of its share of such costs. Instead, insurance enterprises may have to make assumptions about future events, such as when the fund will incur costs and pay claims, that will determine the amounts and the timing of assessments. Information about current or projected market shares, premiums by state, and premiums by line of business generally should be used to estimate the amount of an insurance enterprise's future assessments that meet this criterion for accrual.

18. Estimates of loss-based assessments should be consistent with estimates of the underlying incurred losses and should be developed based on enacted laws and expected assessment rates.

Application of Guidance

19. A discussion on applying the conclusions in paragraphs 10 through 18 to the three methods of assessing guaranty-fund assessments and the two methods of assessing other assessments (as described in paragraphs 4 and 7) follows:

a. *Retrospective-premium-based assessments*. An assessment is probable of occurring when a formal determination of insolvency occurs. At that time, the premium that obligates the member insurer for the assessment liability has already been written. Accordingly, an insurance enterprise that has the ability to reasonably estimate the amount of the assessment should recognize a liability for the entire amount of future assessments related to a particular insolvency when a formal determination of insolvency is rendered.

b. *Prospective-premium-based assessments*. The event that obligates the member insurer for the assessment liability generally will be when the insurance enterprise writes, or is obligated to write,[5] the premiums on which the expected future assessments are to be based. Therefore, the event that obligates the member insurer generally will not have occurred at the time of the insolvency.

In states that, through law or regulatory practice, provide that an insurance enterprise realistically cannot avoid paying a particular assessment in the future (even if the insurance enterprise reduces premium writings in the future), the event that obligates the member insurer is a formal determination of insolvency. An insurance enterprise that has the ability to reasonably estimate the amount of the assessment should recognize a liability for the entire amount of future assessments that cannot be avoided related to a particular insolvency when a formal determination of insolvency occurs.

In states without such a law or regulatory practice, the event that obligates the member insurer occurs when the insurance enterprise writes, or is obligated to write, the premiums on which the expected future assessments are to be based. An insurance enterprise that has the ability to reasonably estimate the amount of the assessments should recognize a liability when the related premiums are written or when the insurance enterprise becomes obligated to write the premiums.

c. *Prefunded-premium-based assessments*. A liability for an assessment arises when premiums are written. Accordingly, an insurance enterprise that has the ability to reasonably estimate the amount of the assessment should recognize a liability as the related premiums are written.

d. *Premium-based assessments for other assessments*. Premium-based assessments for "other assessments," as defined in paragraph 6, would be accounted for in the same manner as prefunded-premium-based assessments described above.

e. *Loss-based assessments*. An assessment is probable of being asserted when the loss occurs. The underlying cause of the assessment also has occurred when the loss occurs. Accordingly, an insurance enterprise that has the ability to reasonably estimate the amount of the assessment should recognize a liability as the related loss occurs.

Present Value

20. Current practice is to allow, but not require (with limited exceptions, such as pensions and postretirement benefits), discounting of liabilities to reflect the time value of money when the aggregate amount of the obligation and the amount and timing of the cash payments are fixed or reliably determinable for a particular liability. Similarly, for assessments that meet those criteria, the liability may be recorded at its present value by discounting the estimated future cash flows at an appropriate interest rate.

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[5] For example, multiple-year contracts under which an insurance enterprise has no discretion to avoid writing future premiums.

Reporting Assets for Premium Tax Offsets and Policy Surcharges

21. When it is probable that a paid or accrued assessment will result in an amount that is expected to be recoverable from premium tax offsets or policy surcharges, an asset should be recorded for that recovery in an amount that is determined based on current laws and projections of future premium collections or policy surcharges from in-force policies.[6] Accordingly, asset recognition would be limited normally to life and health enterprises that are subject to retrospective-premium-based assessments. Amounts that are expected to be recoverable through their inclusion in future premium rate structures should not be recognized as assets. Any assets recognized that are related to liabilities reported at discounted amounts should be discounted similarly.

Disclosures

22. FASB Statement No. 5, FASB Interpretation No. 14, and American Institute of Certified Public Accountants (AICPA) SOP 94-6, *Disclosure of Certain Significant Risks and Uncertainties*, address disclosures related to loss contingencies. That guidance is applicable to assessments covered by this SOP. Additionally, if amounts have been discounted, the insurance enterprise should disclose in the financial statements the undiscounted amounts of the liability and any related asset for premium tax offsets or policy surcharges as well as the discount rate used. If amounts have not been discounted, the insurance enterprise should disclose in the financial statements the amounts of the liability, any related asset for premium tax offsets or policy surcharges, the periods over which the assessments are expected to be paid, and any recorded premium tax offsets or policy surcharges expected to be received.

EFFECTIVE DATE AND TRANSITION

23. This SOP is effective for financial statements for fiscal years beginning after December 15, 1997. Early adoption is encouraged. Previously issued annual financial statements should not be restated. Initial application of this SOP should be as of the beginning of an insurance enterprise's fiscal year (that is, if the SOP is adopted prior to the effective date and during an interim period other than the first interim period, all prior interim periods should be restated). Insurance enterprises should report the effect of initially adopting this SOP in a manner similar to a cumulative effect of a change in accounting principle (refer to paragraph 20 of Accounting Principles Board [APB] Opinion No. 20, *Accounting Changes).*

The provisions of this Statement of Position need not be applied to immaterial items.

[6] Property and casualty enterprises would be limited to recognition of assets related to premiums that have already been written. For purposes of this SOP, in-force premiums exclude expected renewal premiums from short-duration property and casualty policies.

BASIS FOR CONCLUSIONS

24. This section discusses considerations that were deemed significant by members of the AICPA Accounting Standards Executive Committee (AcSEC) in reaching the conclusions in this SOP. It provides background information and includes reasons for accepting certain views and rejecting others.

25. The financial reporting literature does not address explicitly accounting for guaranty-fund and other assessments and related premium tax offsets and policy surcharges of insurance enterprises. AcSEC considered the following pertinent literature in reaching the conclusions in this SOP:

- FASB Statement No. 5, *Accounting for Contingencies*
- FASB Statement No. 60, *Accounting and Reporting by Insurance Enterprises*
- FASB Statement No. 87, *Employers' Accounting for Pensions*
- FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss*
- FASB Interpretation No. 39, *Offsetting of Amounts Related to Certain Contracts*
- AICPA SOP 94-6, *Disclosure of Certain Significant Risks and Uncertainties*
- Emerging Issues Task Force (EITF) Issue No. 91-10, *Accounting for Special Assessments and Tax Increment Financing Entities*
- EITF Issue No. 92-13, *Accounting for Estimated Payments in Connection with the Coal Industry Retiree Health Benefit Act of 1992*
- EITF Issue No. 93-5, *Accounting for Environmental Liabilities*
- EITF Issue No. 93-6, *Accounting for Multiple-Year Retrospectively Rated Contracts by Ceding and Assuming Enterprises*
- FASB Concepts Statement No. 6, *Elements of Financial Statements*
- Securities and Exchange Commission (SEC) Staff Accounting Bulletin (SAB) No. 62, *Discounting by Property/Casualty Insurance Companies*
- SEC SAB No. 92, *Accounting and Disclosures Relating to Loss Contingencies*

Reporting Liabilities

26. FASB Statement No. 5, paragraph 8, requires accrual of a liability when "a. Information available prior to issuance of the financial statements indicates that it is probable that . . . a liability has been incurred at the date of the financial statements" and "b. The amount of loss can be reasonably estimated." With respect to assessments, FASB Statement No. 5, paragraph 33, states, in part:

> The following factors, among others, must be considered in determining whether accrual and/or disclosure is required with respect to pending or threatened litigation and actual or possible claims and assessments:
>
> a. The period in which the underlying cause (i.e., the cause for action) of the pending or threatened litigation or of the actual or possible claim or assessment occurred.

FASB Statement No. 5, paragraph 34, states, in part:

> As a condition for accrual of a loss contingency, paragraph 8(a) requires that information available prior to the issuance of financial statements indicate that it is probable that an asset had been impaired or a liability had been incurred at the date of the financial statements. Accordingly, accrual would clearly be inappropriate for . . . assessments whose underlying cause is an event or condition occurring after the date of financial statements . . . .

27. Therefore, for a liability to be recognized in the financial statements, the underlying cause must have occurred on or before the date of the financial statements. The SOP identifies the event that obligates a member insurer for each type of assessment, which is the underlying cause.

28. In reaching the conclusions in this SOP concerning when to recognize liabilities for assessments, AcSEC considered the definition of liabilities in paragraph 35 of FASB Concepts Statement No. 6 and the concept of present obligation:

> Liabilities are probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events. [Footnote references omitted.]

29. To apply the definition of liabilities in paragraph 35 of FASB Concepts Statement No. 6 to assessments, AcSEC considered the underlying cause that creates a present obligation for insurance enterprises to pay assessments. In order to have a present obligation, the insurance enterprise realistically must have little or no discretion to avoid the future sacrifice, and the event that obligates the insurance enterprise must have occurred no later than the date of the financial statements.

AcSEC concluded that the fundamental differences in the assessment mechanisms justified identifying different events for the three primary types of guaranty-fund assessments and the two types of other assessments (as stated in paragraphs 4 and 6) that would obligate the insurance enterprise and require recognition of a liability.

30. *Assessments Based on Premiums*. Guaranty funds and other assessment funds allocate their costs to insurance enterprises through assessments based on premiums or losses (See paragraph 7). For assessments based on premiums, AcSEC concluded that the writing of premiums on which a potential assessment is based is the underlying cause of an insurance enterprise's obligation to pay cash in the future. In some circumstances, the insurance enterprise has the option of reducing or eliminating its premium-writing activity, thereby reducing or eliminating its assessment. As discussed in paragraph 18, however, some states, through law or regulatory practice, provide that an insurance enterprise cannot avoid paying a particular assessment even if the insurance enterprise reduces premium writings in the future. For example, in certain states, an insurance enterprise may remain liable for assessments even though the insurance enterprise discontinues the writing of premiums.

31. In making its decision, AcSEC was influenced by the fact that insurance enterprises that enter a new state or increase market share in a state will be required to pay assessments for an insolvency that occurred before they entered that state or increased their market share. The fact that such insurance enterprises will have to pay assessments for insolvencies that occurred previously supports the conclusion that the writing of premiums is the underlying cause of the assessments. The alternative conclusion, that is, to recognize the liability based on expected future premiums, would require a new market entrant to recognize a liability on the date it commences business.

32. Alternative view. For premium-based guaranty-fund assessments, AcSEC considered whether the insolvency should be considered the underlying cause of an insurance enterprise's obligation to pay future assessments, irrespective of the legal basis used by the state insurance department to determine the amount due from each insurance enterprise subject to the assessment. Under this view supported by a minority of AcSEC, an enterprise would recognize a liability when an assessment is probable upon the formal determination of insolvency and when the amount of the

assessment can be reasonably estimated. Those that supported the insolvency as the recognition criterion did so under the theory that the insurance industry will eventually be responsible for the entire liability and most companies will not cease writing premiums and avoid the assessment.

33. FASB Statement No. 5 may be read to support either recording a liability at the date of the insolvency or recording a liability when the premium is written. In order to determine when to record the liability for the assessment, defining the event that gives rise to the liability was necessary. AcSEC concluded that the insolvency is the initial event that will obligate the insurance enterprise to a liability at some point either currently or in the future. AcSEC further concluded that if at the time of the insolvency law or regulatory practice obligates the insurance enterprise to pay some portion of the insolvency, a liability should be recorded. However, if an insolvency occurs but no law or practice obligates the insurance enterprise, then the event that binds the insurance enterprise is the writing of the premium. Although the insolvency is what obligates the guaranty fund, AcSEC concluded that writing the premium is the event that requires recognition of a liability for prospective-premium-based assessments when an insurance enterprise is not legally obligated to pay assessments until future premiums are written.

34. AcSEC believes that a number of analogies support the conclusions in this SOP. For example, in EITF Issue No. 93-6, a ceding enterprise would recognize a liability for obligatory retrospectively rated contracts only to the extent that it has an obligation to pay cash (or other consideration) to a reinsurer that would not have been required in the absence of experience under the contract. Furthermore, EITF Issue No. 93-6 specifically prohibits ceding companies from recognizing liabilities for amounts expected to be paid in the future that relate to prior catastrophe losses (for example, through increased costs of reinsurance) when no contractual obligation to make such payments exists. AcSEC believes that insurance enterprises have no contractual obligation to pay assessments until the premiums on which the assessments are to be based are written.

35. In EITF Issue No. 92-13, the EITF reached a consensus that allowed enterprises with operations in the coal industry to account for their obligations under the Coal Industry Retiree Health Benefit Act of 1992 (which created a fund to pay benefits related to certain coal-industry benefit trusts that were operating at deficits) as multiemployer pension plans. Guaranty funds are similar to multiemployer pension plans in that each insurance enterprise's payments to the fund are used to satisfy the general obligations of the fund and are not segregated for the benefit of any one enterprise.

36. AcSEC also believes that accounting for claims-made insurance provides an appropriate analogy. In claims-made insurance, the insured event is the reporting, during the term of the policy or within a specified period following the coverage period, to the insurer of a claim for a covered loss. For such policies, insurance enterprises estimate a liability for unpaid claims based only on claims reported, despite the fact that there may be other losses that have been incurred that eventually will result in claims to that insurance enterprise. The agreement between the insurer and the insured is that the insurance enterprise is not obligated to cover those unreported losses, unless that insurance enterprise is providing coverage under a claims-made policy when the claim is made. Similarly, the substance of the arrangement for most premium-based assessment mechanisms is that an insurance enterprise is obligated to pay assessments only when the premiums on which the assessments are to be based are written.

37. Although insurance enterprises may be able to determine that future assessments are probable for some period of time before a formal determination of insolvency occurs, AcSEC concluded that assessments should not be considered probable until a formal determination of insolvency occurs, unless the assessments are being made by a prefunded guaranty fund. AcSEC believes that the formal determination date is the most objectively determinable measurement date

and that requiring its use will foster comparability in reporting. Furthermore, AcSEC believes mere speculation about an insurance enterprise's insolvency should not be considered an accounting event.

38. *Assessments Based on Losses*. For loss-based assessments, AcSEC concluded that the underlying cause of an insurance enterprise's obligation to pay the assessment is the incurrence of losses on which the assessments are expected to be based (regardless of whether the assessment is based on paid or incurred losses). Further, AcSEC believes that insurance enterprises have little or no discretion to avoid the future sacrifice once the losses on which the assessments are expected to be based have been incurred. Unlike premium-based assessments, where the insurance enterprise has the discretion to write or to not write premiums (even if it is unlikely that the insurance enterprise will not write such future premiums), an insurance enterprise is obligated to pay the loss-based assessments once those losses are incurred.

39. AcSEC considered whether it is appropriate to recognize a liability for assessments for administrative-type state funds as the losses on which the assessments are based are incurred by member insurers. Some have indicated that it is not appropriate to accrue a liability for operating costs of a state fund that have not yet been incurred by the state fund. AcSEC concluded that loss-based assessments for administrative-type funds should be accrued as losses of a member insurer occur if it is probable that a related assessment will be made. AcSEC believes this is similar to the accounting in FASB Statement No. 60, whereby liabilities for claim adjustment expenses that relate to unpaid claims are accrued before the costs are incurred. Once the losses are incurred, insurance enterprises have little or no discretion to avoid paying the assessment.

Present Value

40. AcSEC believes that recognizing assessment liabilities at their present value provides the most representative measure of the economic substance of the situation. Nevertheless, AcSEC declined to mandate present-value-based measurements while the FASB is still considering the role of present-value-based measurements in financial reporting. For the same reason, this SOP provides no detailed guidance on present-value methodologies and discount rates.

Premium Tax Offsets, Policy Surcharges, and Future Rate Making

41. AcSEC believes that, when it is probable that paid or accrued assessments will result in premium tax offsets or policy surcharges, recognition of an asset based on current laws and projections of future premium collections from in-force policies is appropriate. In making this determination, AcSEC considered the characteristics of an asset in paragraph 26 of FASB Concepts Statement No. 6, which states, in part:

> An asset has three essential characteristics: (a) it embodies a probable future benefit that involves a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash inflows, (b) a particular entity can obtain the benefit and control others' access to it, and (c) the transaction or other event giving rise to the entity's right to or control of the benefit has already occurred.

42. Even though premium tax offsets, policy surcharges, and the incorporation of assessment costs in future premium rate structures have a similar purpose, that is, to allow insurance enterprises to recoup some portion of assessment costs, AcSEC concluded that the ability to include assessments in future premium rate structures should be treated differently from premium tax offsets and policy surcharges. Premium tax offsets and policy surcharges are statutorily provided and generally are not dependent on the ability or intent of an insurance enterprise to take

any action. In contrast, an insurance enterprise needs to write future premiums before the ability to include assessments in future premium rate structures would result in recovery of costs. Thus, AcSEC concluded that the statutory ability to include assessment costs in future premium structures should not result in asset recognition and should not be used to reduce current assessment costs.

43. To the extent that paid or accrued guaranty-fund costs are expected to result in premium tax offsets or policy surcharges, AcSEC believes that it is appropriate to consider recognition of such recoveries as assets. AcSEC believes that the amount of the asset should be limited to expected future premiums related to policies in force at the measurement date. AcSEC considered whether it is appropriate to consider all expected future premiums in establishing such recoveries. However, AcSEC concluded that this approach would introduce an inconsistency with AcSEC's decision not to recognize a liability for guaranty-fund and similar assessments that are based on future premiums. Therefore, AcSEC determined that considering all expected future premiums in evaluating the recoverability of premium tax offsets or policy surcharges is not appropriate.

Transition

44. AcSEC decided to prohibit retroactive application of this SOP. AcSEC recognizes the benefits of comparative financial statements but believes that the information needed for insurance enterprises to create the necessary estimates of liabilities for future assessments and of the timing and amounts of cash flows from a past perspective may not be available.